The

Specialist

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Hunting value: Schemes move down the property ladder

Pensions expert

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Schemes under pressure from diminishing returns are keeping it real

Defined benefit pension schemes have been ploughing money into real assets in the past year as the brutal reality of low-yield fixed income and the prospect of rising inflation and interest rates take hold.

Data show real assets had more inflows than any other alternative asset in the past year, with property (or real estate depending on where you are in the world) the big winner.

But are schemes a bit late to the game? The long-term nature of trustee boards' decision-making means some schemes have missed out on investment opportunities. One consultant has urged his clients to move quickly to avoid missing out on potential returns (see pages 12-15).

As large overseas investors swoop into London prime property, many UK schemes, with relatively small pots of cash compared with Middle-Eastern sovereign wealth funds, have sought more substantial returns in secondary property outside of the capital.

Infrastructure was once again at top of agenda for schemes. This year the Pensions Infrastructure Platform unveiled its much-anticipated fund structure. However, the need to take more risk than originally anticipated forced some founding members out. At the same time, some local authority schemes, such as Avon, Swansea and Dorset, are teaming up to make infrastructure investments (see pages 18-19).

A growing area of interest has been the use of real assets in defined contribution schemes. Although some schemes, such as state-sponsored Nest, have been courting Pip, the fragmented nature of the DC market, and the perceived need for daily liquidity has made investments difficult.

There is also a question around whether the at-retirement flexibility announced in this year's Budget will affect investments in the assets (see pages 22-23). Will the changes thwart forays or will it open up opportunities? It is a waiting game until schemes get their heads around the changes. I, however, put my money on investments; as DB slowly dies out, I predict asset managers will be champing at the bit to get their hands on the growing pools of DC money.

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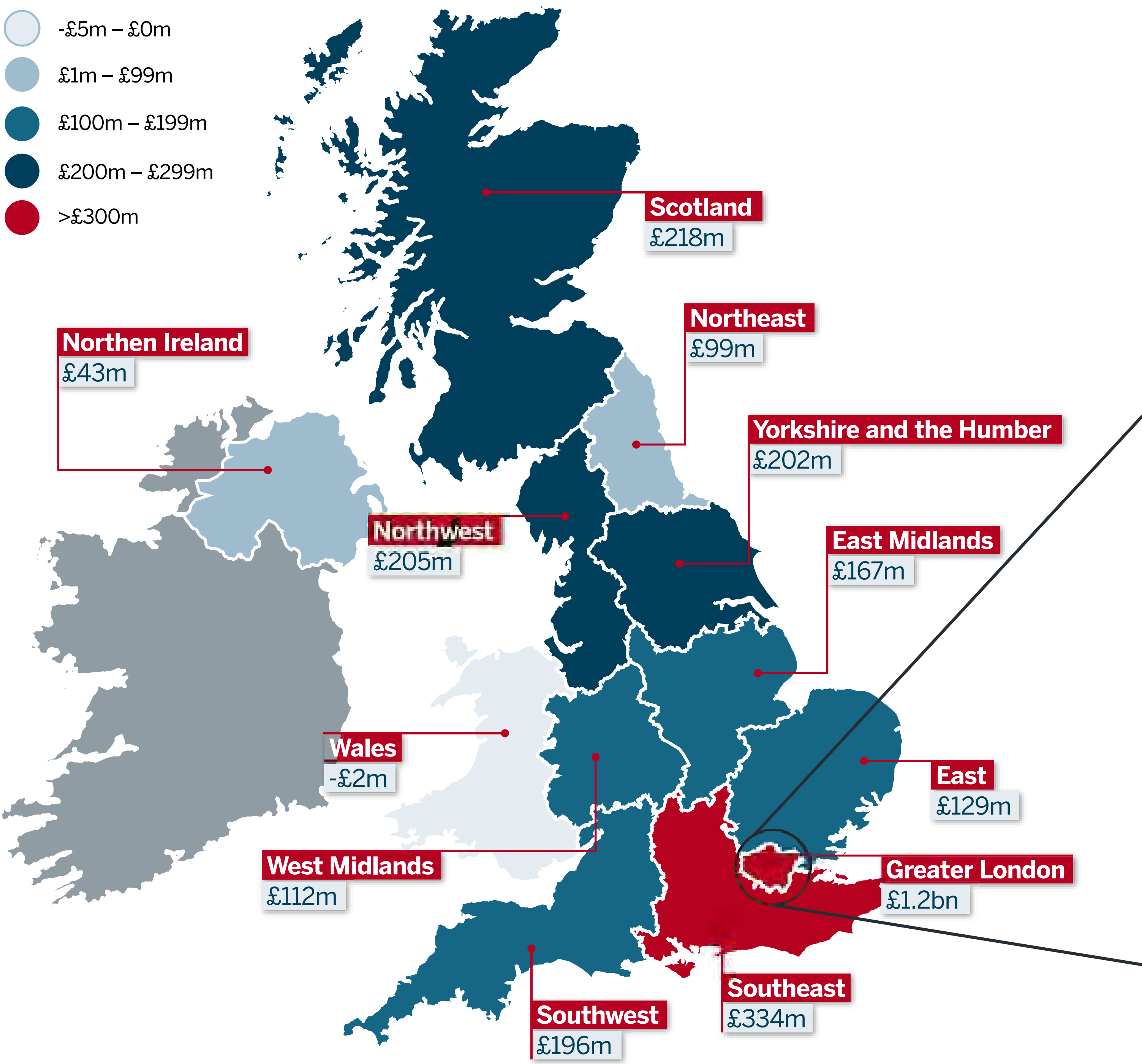
Feature The big picture

The regional divide

Scheme investment patterns reveal the split between core and secondary commercial property



Source: IPD

Pension schemes have focused on domestic investment over the past year, as the following pages reveal. Data from index provider IPD demonstrates the majority of this investment centring on prime London property.

According to the data, schemes made a net investment of £1.2bn in London, compared with £682m in the rest of the southeast, and £1.4bn in the remainder of the UK.

One trend that has been seen this year has been a move into the secondary market.

Outside of London and the southeast, Scotland saw the highest investment with £218m, followed by the northwest and Merseyside which saw investments of £205m.

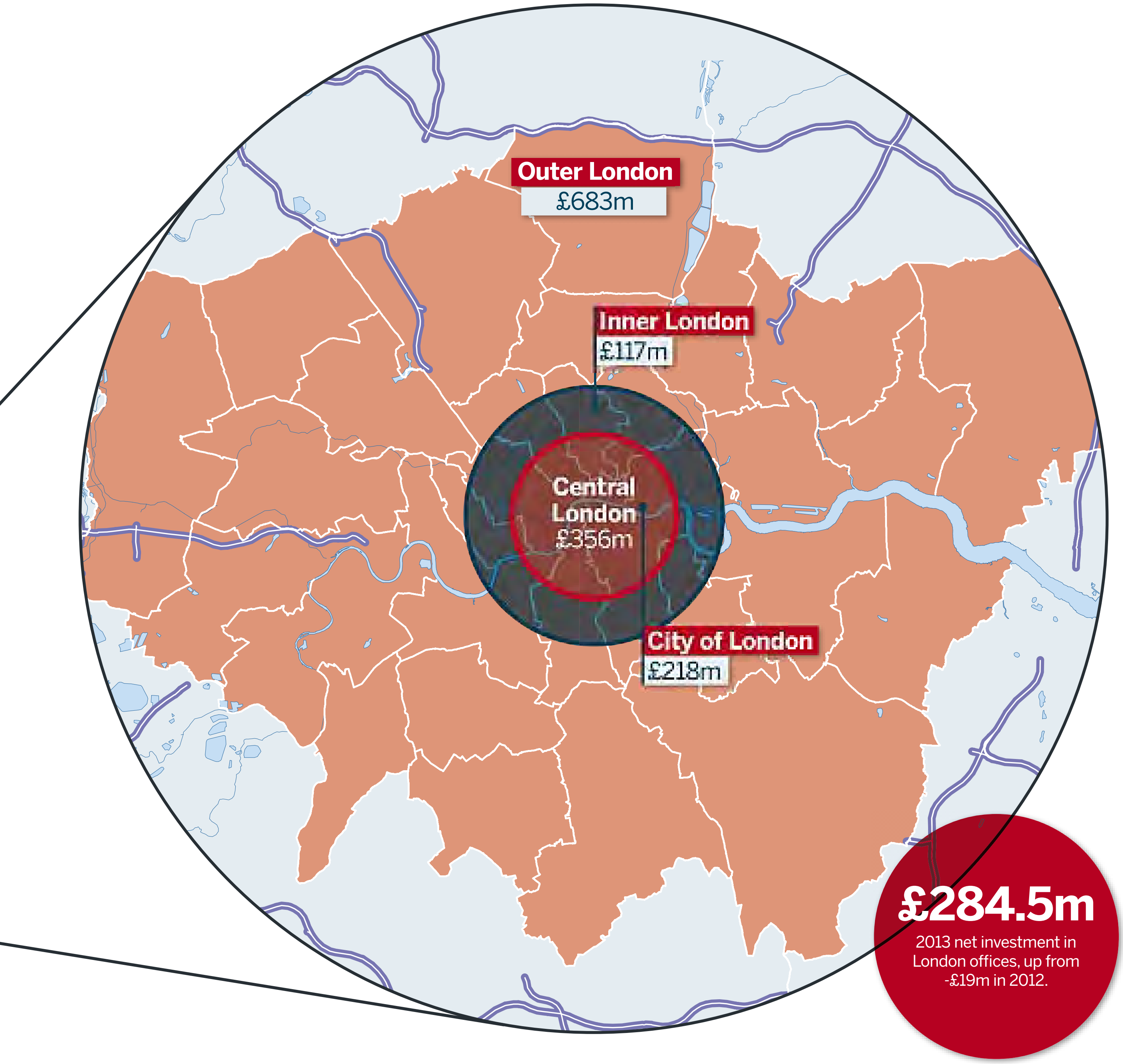
Institutional asset managers have been hot on this trend. Earlier this year, fund manager Legal & General Property acquired an £87m office building in Birmingham. IPD data show investments of £112m in the West Midlands.

Shopping for retail

The data also show retail properties were a favourite among schemes, with almost £1.4bn ploughed into the sector. Offices were a close second with inflows of £733m.

However, many schemes this year have diversified into alternative areas of commercial property, with almost £342m invested in these types of assets.

In April, M&G Investments sold a Sainsbury's supermarket in Worcester to the BP Pension Scheme for £27.3m.



Feature Data analysis

Property tops the table while infra waits in the wings

Alternatives have piqued the interest of pension schemes looking for inflation linkage, with property leading the way

Lisa Botter

Defined benefit schemes are increasingly investing in real assets, including property, infrastructure and forestry to use their inflation-linked characteristics to shore up portfolios against expected rate rises.

According to data from Financial Times service MandateWire, property was the clear favourite alternative asset over the past year, receiving more inflows than infrastructure, hedge funds and private equity (see graph one).

There were 56 instances of inflows from the UK schemes interviewed by MandateWire in the year to March 2014, including awarded mandates and assets reweighted into property, amounting to nearly £4bn.

This was down from the previous year, which saw 59 instances, but up from the year of April 2009 to March 2010 which saw 35 awards.

According to the National Association of Pension Funds' 2013 annual survey, more than a third of DB schemes had invested in commercial real estate, while a further 11 per cent had considered investing.

The major themes in property investment in the past year are schemes upping their allocations and diversifying allocations to take advantage of opportunities, investment consultants say.

While 'core' commercial property has previously been the focus, many schemes are moving towards secondary property where better value can be found.

Ciaran Mulligan, global head of manager research at consultancy Buck Global Investment Advisors, says property aligns itself very well in a pension fund's portfolio as it is a long-term asset, is tangible and has the income stream of bonds and the growth potential of equities.

"For most funds there is a case to be made for property," he says. "[However] what those funds are investing in has changed over time."

Nick Spencer, head of alternatives in the consultancy team at Russell Investments, says there has been an increased interest in property and real assets, in particular infrastructure.

"[Schemes] are thinking of broader ways they can add to the portfolio," says Spencer. "We are in a situation where equities are around market highs... Rising rates will make fixed income returns rather muted.

"With that outlook, schemes are looking to diversify portfolios and that is where real assets are coming into their own."

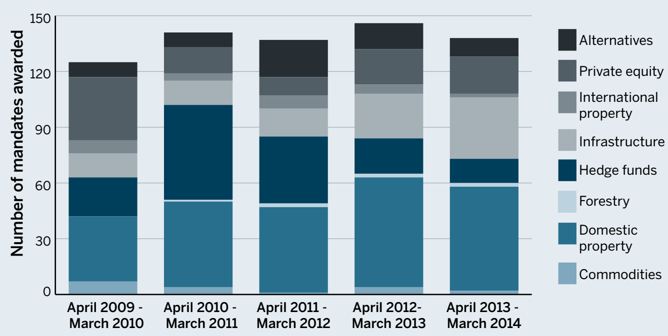
He adds that although UK schemes have been lagging their European counterparts it is expected that will follow with increased investments.

"People are interested in the different ways they can access real estate, the different purposes they can use it [for], and they are thinking both domestic and globally," Spencer says.

Focus shift

Schemes have had a particular focus on core prime property which has performed well, but

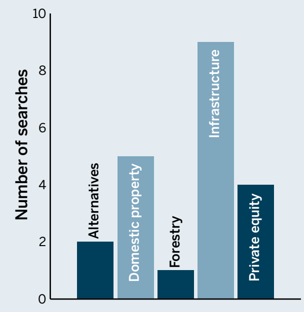
Alternative asset inflows: 2009-2014



Source: MandateWire

Future inflows

Jan 2014 – April 2014



Source: MandateWire

Schemes are looking to diversify portfolios and that is where real assets are coming into their own

Nick Spencer, Russell Investments

the spread in valuations between prime and secondary assets has seen a shift.

"At the moment we are seeing interest in moving to the slightly more secondary locations, outside that core prime. Now that the gap between the prime and secondary is so wide, there is a particular opportunity," Spencer says.

The focus has been on properties in secondary locations around the country, however there is an opportunity for distressed buildings in prime locations.

"To move to slightly more value-added type strategies, where you look at secondary properties in prime locations – look to make them prime and get the uplift in both the investment and also the valuation premium in the market," Spencer says.

Schemes are also diversifying into long-lease-type properties and there has also been an interest in debt strategies in the hope of larger, more stable cash flows.

Buck's Mulligan says that what schemes are accessing under the guise of property has changed.

"The funds we have pension [schemes] increase their allocation to have been the inflation-linked properties," he says, which include long-lease property.

Schemes have also been looking at international, listed and residential property, Mulligan adds.

Schemes looking internationally are focusing on Asia, the US and distressed sellers in Europe.

"It has become a lot more varied in how pension funds are getting exposure to property," he says. "Just because the accessibility into these sub-asset classes has increased."

Real assets

MandateWire data show schemes were also diversifying into infrastructure. In the past year there were 33 awards, amounting to inflows of almost £1.5bn. This is up considerably from the previous year ending in March 2013, which had 24 awards, and from the year ending March 2019, which had just 13 awards.

There were also inflows of £25m in forestry.

The data indicate infrastructure could be a strong contender in 2014 with nine searches for the asset class recorded (see graph two). This is compared with five searches for domestic property and one for forestry.

The NAPF survey backs this up, with almost a quarter (23 per cent) of DB schemes having made some investment in infrastructure, with a further 18 per cent of respondents considering investing.

Russell's Spencer says schemes have been diversifying into real assets, with infrastructure remaining the most popular choice.

Buck's Mulligan agrees. He says: "There have been flows into real assets due to the advantageous illiquidity premium."

But Spencer says some are finding that actually executing the investments can be "challenging".

Another concern is the limited opportunity set in the UK, although that may be evolving. Spencer says: "We are seeing the emergence of some global open-ended infrastructure funds, as well as selective close-ended funds."

Some schemes are looking internationally as UK prices have been bolstered by strong demand, so some of the valuation opportunities can be better overseas.

There is also interest in farmland and timber as schemes look to diversify further. "The interest in farmland and timber have come from the larger funds that are looking to diversify and take advantage of the cash flows and long-term trends in those assets," says Spencer.

However investing can also be a challenge for many investors, particularly with valuations looking high for timber and farmland, he adds.

"The way I think larger investors are addressing that is looking for very specific opportunities, where they can get the competitive edge," Spencer says.

Lisa Botter is deputy editor at Pensions Expert

Case study

Plumbing and Mechanical Services Industry Pension Scheme

In October Pensions Expert reported on the £1.4bn Plumbing and Mechanical Services Industry Pension Scheme deciding to expand its property investment for the second year running.

In 2012, the scheme increased its investment with property manager DTZ Investment Management by £25m to £125m and was in the process of bringing that total up to £150m. The assets targeted include offices, and town centre and out-of-town retail buildings.

At the time, scheme secretary and pensions manager Robert Burgon said it was a strategic move. "It is returns we are looking for. We can get a yield of over 7 per cent on most of the properties in the portfolio," he said.

The scheme partly attributed its strong investment performance over recent years to its experience in the property market.

It opted for a segregated fund rather than a pooled mandate following its experience of volatility in the property market.

"Last time around we realised we were very fortunate because the predictions for commercial property were not good," said Burgon. "If we had stayed in, we may have found ourselves stuck in."

Feature Case study

Branching out to hedge against inflation rises

Will tentative links to global inflation and steady returns justify a bold investment in timber and farmland?

By Emma Powell

Clwyd Pension Fund has allocated 2 per cent of its assets to timberland and agriculture, attracted by the chance to earn higher returns and hedge against a rise in inflation.

The scheme has allocated a further £10m to two direct operational agriculture funds and £4.4m to timber since 2011, according to the scheme's 2013 annual report.

This is part of its 15 per cent real asset portfolio, which also includes allocations to property, infrastructure and commodities.

The £1.2bn scheme is one of only a handful in the UK to invest in timber and agriculture, as many schemes have been deterred by the illiquidity and lack of investor familiarity surrounding the asset classes.

Clwyd Pension Fund made an initial investment of £9.5m in timberland in 2007, according to it's most recent annual report.

"There was logic around some sort of inflation hedge – we expect some sort of global inflation link there," says Phillip Latham, manager at the scheme. "There was probably an environmental factor as well if it's well-managed forestry or agriculture."

"That's just not the case for agriculture and timber," he says. "You are exposed to market fluctuations, so while over the long term there may be some correlation with inflation, it's not as strong as infrastructure."

Examining returns

Since most of the timber and agriculture funds invested in are euro-denominated and many of the underlying investments are dollar-denominated, it can be difficult to drill down to examine returns, says Latham.

"The difficulty [in] measuring returns is around currency," he says. The scheme hopes to make 8 to 10 per cent annualised returns over the investments' 10-year lifetime.

"At the moment they're lower than expected, but you have to keep in mind we're investing in vehicles that are similar to private equity," he says.

The scheme's investments in timberland and agriculture returned around 7 per cent in the 12 months to March 31 2013, according to the annual report.

Most of this return will be attributed to timber investments, says Latham, adding that some of its allocation is still at the investment stage.

Although the allocation to real assets has been set at 15 per cent, there is room to increase this, Latham says. He adds the scheme was also drawn to making the investment by the types of returns that could be generated.

These investments have a relatively long lock-in and most of them are not cheap

Alex Koriath, KPMG

The Welsh scheme has dipped a toe into timber investing

Locking up capital

Illiquid assets can be more problematic for private sector defined benefit schemes, many of which are closed or closing to new members and thinking about derisking, says John MacDonald, head of alternatives research at consultancy Hymans Robertson. "In the past year or two, local authority schemes have had a lot more on their plates and a lot more to worry about than looking at new types of assets," he says.

However, MacDonald is not convinced investing in these asset classes does provide a sufficient inflation hedge in the same way as infrastructure, since the latter tends to be regulated and has a genuine global linkage to inflation.

Timberland and agriculture investments historically have a relatively attractive risk/return profile and low correlation with a number of other asset classes, says Alex Koriath, head of manager research in KPMG's investment advisory practice.

However, the private equity-like partnership structures through which these assets are usually accessed come with a range of disadvantages for investors, he says.

"These investments have a relatively long lock-in, they tend to have a drawdown structure and most of them are not cheap in terms of total expense ratios," says Koriath.

Emma Powell is a reporter at Pensions Expert

How to avoid being wowed by rewards while overlooking risk

Much is said of property's suitability to wider scheme objectives – but don't ignore the dangers

Catherine Lafferty

As property investment comes back into favour, the risks of holding the asset – such as hidden fees and illiquidity – have come to the fore. But clear planning and a good manager can help mitigate these risks, industry figures say.

Justin Brown, UK property fund manager at BlackRock, says risks include tenant default and low liquidity. "Real estate is quite a lumpy asset," he says. The individual assets tend to be big in terms of lot size and because there is not a specific marketplace for them as there is with shares; it takes time to sell the asset. He adds: "During the financial crisis the major risk was liquidity – you couldn't sell."

Paul Richards, head of European real estate at consultancy Mercer, cites the physical restructuring of property markets as both a potential risk and a value-enhancing opportunity.

He says: "By this I mean such things as high streets continuing to shrink. This is a risk if you own a shop in the wrong part of the high street. It can also be an opportunity for such value-enhancing activity as converting to residential, which is what a lot of shops originally were anyway."

Other risks include a rise in interest rates and bond yields which would inevitably lead to a rise in property yields and a fall in values, Richards adds.

Larger schemes could consider having their own property portfolio and appointing a manager to run it for them.

On the creation of a specific segregated direct property portfolio a number of checks and balances would be put in place to minimise threats to its operation, resulting from the ebb and flow of the sector's performance.

Typically a manager agreement will be put in place, with performance objectives, investment restrictions and the scope of services delineated.

Nick Duff, principal in the alternative investments team at consultancy Aon Hewitt, says: "Such agreements would need to make sure the performance objectives are sensible and achievable; one would not want to set one seeing them take too much risk."

There will also be the need for a sensible set of investment restrictions, for example setting a minimum number of properties, a maximum exposure to any one property and any one tenant.

Duff asserts: "[Managers] need to make sure fees are charged in right way, ensuring you understand as a client what services managers are providing. With property there are a lot more hidden costs associated with that asset class compared with, for example, fixed income."

While tenant demand has picked up, the underlying economic growth on which it is based is still sluggish

Paul Richards, Mercer

Managers will ensure appropriate property checks are undertaken, that the likes of contamination audits take place and structural surveys done.

Regulatory threat

Other risks to the sector include the possibility the government may introduce legislation that would affect performance, such as the imposition of rent controls, or of more punitive taxation either in the form of stealth or direct taxes.

Duff says: "The government has been pretty good to the property sector in recent years but stamp duty, which was 1 per cent 20 years ago, now stands at 4 per cent."

Most pension schemes tend to hold commercial rather than residential property, though there has been some movement in that area. The heavy tilt towards commercial property signals the other key risk pension schemes property investments face.

Duff says: "With commercial property there is a strong correlation between its performance and with wider economic activity." P

Catherine Lafferty is a freelance journalist

Advertisement

Residential property is the new commercial investment market

Institutional investors should grasp opportunities in the UK's residential rental market as demand for housing goes through the roof, says Ed Crockett, Director of Residential Fund Manager Property

In recent decades, institutional investors have been reluctant to invest in the UK residential market. We, however, foresee a material allocation of capital to the sector reflecting positive dynamics and improved accessibility to the market, allied with long-term growth due to favourable supply-demand dynamics.

Our comments are not a reaction to short-term pricing movements, but driven by multiple, positive, long-term factors. We therefore strongly recommend institutional investors should at a minimum be assessing their prospective approach to this market.

The residential market is very large and the opportunity set for investors is growing rapidly

The UK residential market already dwarfs the commercial property market. The British Property Federation estimates the total value of UK commercial property to be just over £800bn, of which less than a quarter is covered by the IPD Annual Index[1]. While this is not an insignificant number in itself, it is small in comparison with the UK residential sector, which has a total value six times greater at £4,500bn. To put that in context, this is twice as much as the value of UK equities listed on the London Stock Exchange.

The investable market size appropriate for UK institutions has thus far proved a much smaller universe – but this is at a tipping point. We believe that institutions are on the cusp of a major change in their attitude and behaviour with regard to residential investment in the UK.

The current allocation of UK institutional investors to the entire residential sector is under 4 per cent in the 2012 IPD Annual Index, which is a remarkable statistic, especially when compared with other countries. In the US, a typical allocation by institutional investors to the private rental sector is 25 per cent (in the NCREIF Index), while in some European countries allocations to the residential market are more than 40 per cent.

Supply and demand dynamics are very favourable for investors over the long term

Demand for housing remains exceptionally strong

Ultimately, demand for housing is driven by the growth in the number of people to be housed. The UK government is forecasting net household formation rate of 261,000 a year, equivalent to 5.4 million more households, over the next 20 years. This expansion is leading to the emergence of some substantial tensions.

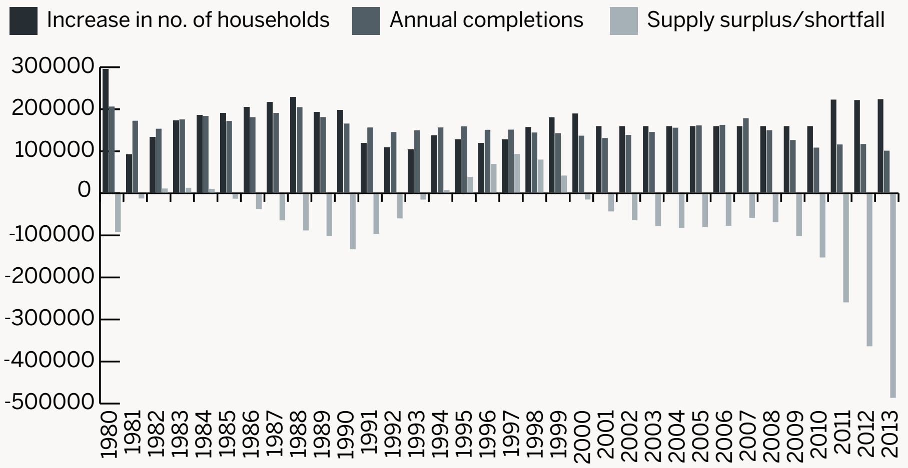
London is an interesting case study that reflects the marked shortfall in housing and potential opportunity for investors. London has added nearly a million to its population over the past 10 years and is expected to do the same over the next decade – this is the equivalent to adding a population greater than that of Leeds in both the last and forthcoming decade.

1 Property Industry Alliance (PIA) Property Data Report 2012

Key points

- The UK residential sector has a total value of £4,250bn, six times greater than that of the UK commercial property sector.
- The UK government is forecasting net household formation rate of 261,000 a year, equivalent to 5.4 million more households, over the next 20 years.
- .The Policy Exchange think-tank suggests a minimum of 1.5 million homes should be built between 2015 and 2020, three times the build rate anticipated for 2013
- London has added nearly a million to its population over the past 10 years and is expected to do the same over the next decade
- More than half of London's households are now renting

Household formation



Source: Aberdeen Asset Management & DCLG

The supply side is unable to keep pace
Despite growing demand, statistics show we are building fewer homes nationally than at any point since the second world war. Data from the Department of Local Communities and Government show household formation has outstripped net household completions (construction) for every year since 1997, leading to a shortfall of some 500,000 units. The Policy Exchange think-tank suggests a minimum of 1.5 million homes should be built between 2015 and 2020, three times the build rate anticipated for 2013.

A consequence of elevated demand and tight supply is very strong growth in property values. In the London residential market, in particular, this has put sustained pressure on affordability for potential buyers for their own occupation. We estimate that the average London first-time buyer, unassisted by parental finance, is now close to 40 years old, implying a long period of renting prior to ownership. We envisage this average age rising rather than falling over the next decade and we suggest that the decision to rent for many UK residents is needs-based given affordability issues. For many London workers there is little choice other than to rent and indeed more than half of London's households are now renting.

We have concerns regarding pricing, but a focused strategy should limit risk
The price of housing in prime central London is high, but our recommendation, to conservative investors, is to focus on a number of key attributes we believe support rental levels and prospective growth.

Our research team has a developed matrix of 'winning' locations to guide our investment strategy. The key factors in the analysis include a large pool of young professional residents, a high level of local recreational amenity (cafes, bars and shops etc) and that a major employment base is efficiently accessible (by time and cost) by public transport. Largely, but not exclusively, this draws us to the suburbs and commuter towns of London and the south east, but many provincial cities offer strong appeal. Ultimately, rents need to be affordable, but that doesn't necessarily mean cheap, as we believe tenants will be prepared to pay for the quality of the product and the variety of tenancies on offer.

The private rented sector is fragmented but a professional institutional sector is emerging
While the pressure to rent in London and the south east is acute, the ownership and management of such investment properties is largely fragmented and disparate. Readers will be familiar with the explosive growth of private landlords utilising buy-to-let mortgages, and while this is arguably a success in establishing a mechanism for rental tenure, it is unusual by international standards. In North America, institutionally owned, purpose-built and well-managed rental blocks are a mainstay of the residential supply. Opportunities to develop, or commit to purchase bespoke rental blocks are now starting to come forward in the UK, alongside management platforms and operators that are experienced and equipped, offering a similar style of rental service to that common in North America.

A significant opportunity exists for investors to be involved in the delivery and management of such properties.

Our conclusion is that institutional investors should now be readying themselves for the wholesale investment opportunities that are being created in the private rented sector residential markets. We believe the fundamentals are strong and durable and that the commercialisation of this fragmented market is a much needed structural change that offers potentially great appeal for long-term investors in the UK.

The value of investments and the income from them can go down as well as up and you may get back less than the amount invested.

Second-tier wins out against core property investments

Property is back on the agenda for trustee boards, but are schemes ready to act when an opportunity presents itself?

Meike Wijers

The ground underneath the bricks and mortar asset class trembled after the downturn in 2008, when a housing and mortgage implosion triggered the global financial crisis. Now the economy is gradually climbing out of recession, the future for property and infrastructure investments is looking more solid. But pension scheme trustees are still wary of these types of illiquid investments.

Evidence that the market is experiencing rosier times is demonstrated by property index provider IPD showing that pension funds significantly increased property investment last year (see table, page 15). This included putting more than £400m into alternative areas of commercial property and showing strong interest in index-linked leases backed by strong covenants. In 2012 £74m was invested in alternative areas, while in 2011 only £9m went to this area in the property market.

When second is best

Trustees are often slightly concerned about large property allocations because they worry about liquidity constraints. "Over recent years, property has been discussed and perhaps discarded by many boards," says Steve Delo, independent trustee at Pan Trustees. But in the past year experts have seen a lot more attention focused on the asset class.

One of the main areas of focus is the secondary market, since the price of prime quality property in the UK has soared. "Trustees are very wary of the primary market, which is pretty overpriced," Delo adds.

During the financial crisis, schemes were looking for the safest investments they could find, says Andrew Jacobson, investment consultant at LCP.

"At the time, they felt that high quality prime London-based properties were a very safe investment, so we saw a lot of money flow into those kinds of assets between 2010 and 2013. That meant that the yield on those properties was reduced quite significantly.

"Looking at it today, it doesn't offer a very attractive return opportunity," he says.

One of the reasons tier-one property has become so expensive is due to international investors sweeping up high-profile properties.

In the past 12 months, more and more UK scheme investors have sought refuge in the secondary property market. These good-quality properties are less expensive than the prime assets found in central London and parts of the southeast.

"The yields available in this sector of the market are well above historic norms," Jacobson says.

In 2000 and even up to 2010, investors were getting a yield of about 2 per cent above gilts. "But today, even though yields have compressed a little bit over the last six months, it is still 6 per cent per annum above gilts," he says. "This is a significant reward to justify the extra risk schemes are taking because they are opting for the second best."

Bubble concerns

This does not mean investors can rest on their laurels – the secondary property market is also subject to possible over-pricing. However, Greg Wright, head of property research in KPMG's investment advisory practice, is still positive about the sub-asset class.

The relatively low-risk, income-driven approach of long-lease has experienced increasing popularity over the past year, and the universe of options is expanding now that more funds have come into this space.

"Funds are still trying to find properties that include a tenant on a long lease, an inflation-proofed income and obviously a

> **This is a significant reward to justify the extra risk schemes are taking**
>
> Andrew Jacobson, LCP


Pension funds have made their first forays into residential and social housing

good-quality tenant. Increasingly, more managers are finding different sorts of assets that fulfil those criteria," Wright says.

A few years ago, the main focus was supermarkets. Now managers are also looking at other sectors such as hotels, car parks, GP surgeries and marinas.

"The only cloud on the horizon is whether the pricing of some of those assets is starting to become quite high, particularly some of the supermarkets," says Wright. "There are still a number of managers buying the Tescos and Sainsbury's of this world, but the yield on those is getting lower and lower."

He warns that yield is probably getting to the point where if it gets much lower, investors may question whether they are going to achieve outperformance targets.

Upping the game

Pan's Delo says consultants have stepped up to the plate by thinking more deeply about property and trying to be less generic in their advice.

> **It is much easier for schemes to invest in residential now, and they are beginning to react to that**
>
> **Christopher Down, Hearthstone**

"Consultants are more specific about the sort of areas in property that trustees should focus on," he says.

Wright argues that managers also have to work harder to get the desired results. When managers cannot turn to buying supermarkets but must find alternative assets, they need to be skilled enough to identify those sorts of assets.

And even when they do, the waiting period for schemes from when they decide to invest and the moment they actually allocate the money can build up to a few years.

"When managers are struggling to find the assets, you could find that the pipeline gets longer and longer. That would be a disappointment to pension funds. When they sign up in 2013, they don't want to be handing over the money in 2015," Wright says.

He adds that managers will have to work a bit harder to source good investments.

According to LCP's Jacobson, time is of the essence. He urges his pension scheme clients to move quickly to avoid missing out on a large part of potential returns. "At the moment it is an attractive investment, but in the past six to 12 months we have seen an increasing number of investors looking to allocate their money to this kind of best-secondary property investment. The impact of that is of course that it pushes up the prices and reduces the yield," he says.

Making an impact?

Some fund managers have seen a trend among schemes, especially council funds, to contribute to the local economy by making impact investments.

Last year, the £13.4bn Strathclyde Pension Fund established a property fund to make investments of less than £10m in local commercial real estate.

Strathclyde's pension fund committee agreed to establish a £50m Clydebuilt Property Fund with Ediston Properties that will invest in the region's commercial sector. The fund will form part of the scheme's New Opportunities Portfolio.

"Market information suggests commercial property in the west of Scotland is increasingly seen as a recovery opportunity in an under-researched market," stated the committee meeting minutes.

The investment is hoped to provide a boost to the local economy, said chair of

Net direct property investments by UK pension funds 2011-13

	Dec 11	Dec 12	Dec 13
Street retails, shopping centres, warehouses	£109m	£176m	£530.8m
Offices	£53.2m	£5.2m	£764.6m
Industrials	£4.4m	£32m	£364.3m
Other commercial	£9.1m	£74.3m	£423m
All	£175.7m	£287.4m	£2,082.7m

Source : IPD (figures rounded to one decimal place)

Strathclyde Pension Fund and Glasgow city treasurer, councillor Paul Rooney.

"I'm positive about seeing more of their money being invested in the communities in which they work and live – supporting native businesses and jobs," he said in a statement.

Strathclyde said the main focus is expected to be commercial property. "Opportunities in residential property and other areas that fit the fund's criteria will be considered," the scheme stated.

In April this year, fund manager Hearthstone Investments reeled in a mandate from the £1.5bn Falkirk Council Pension Fund to invest £30m in social and affordable housing in Scotland.

The investment adds to the supply of new homes and supports local economies, and investors simultaneously benefit from stable, long-term returns.

Christopher Down, chief executive at Hearthstone, says it is a sign that institutional investors are becoming more interested in residential property. "It is a very big asset class – £5trn – but until recently institutions haven't invested in it. It is more management-intensive than a commercial property," he says. "This has given institutions some worries about investing, but with fund managers now beginning to offer investments to pension schemes it means they don't take on that management burden. It is much easier for pension schemes to invest in residential now, and they are beginning to react to that."

Michael Barrie, director at fund manager Legal & General Property, says his team is working on adding new skills to provide intelligence in these markets. "We think there is the need for greater private investments in social housing and health care.

"We have an ageing population and there is still an underprovision of healthcare and care homes across the UK, and potentially more demand for ethical funds. These [are] areas [where] we will push hard."

Barrie adds that social housing corporations do not necessarily go to banks anymore for their funding. "They are looking more and more at private investors and want those investors to be stable providers, so pension funds make an obvious match when it comes to meeting those needs. Real estate is a very physical and obvious way in which you can see that you are making a difference. But it is not something you can do overnight," he says.

Creating a movement

The London Borough of Islington Pension Fund was the first in 2012 to invest 2.5 per cent of the fund's assets into residential housing. The scheme urged other pension funds to follow their lead and join the fund, even talking about a "mass movement to help create the supply of housing that is much needed in the UK". But the appetite among other schemes seems to be lacking.

Mark Gayler, investment manager at Devon Pension Fund, says it is "not really appropriate" for schemes to invest in social housing simply because the local authority that the scheme is run for wants this to benefit the wider community.

Devon has built up its property assets to 10 per cent in the past few years, but is not planning to get involved in the residential market.

"As a fund we have always taken a strong line that we need to maintain our fiduciary duty to make returns for the members of the scheme.

"If we were to invest in... local affordable housing, we could only do that if we could absolutely stipulate that this would get the best return we could possibly get for the money, and not because of any impact it might have on other issues," Gayler says.

Delo tends to agree. He has not found any particular interest in impact investments among trustees. "One of the reasons why a lot of ethical and social constraints don't get properly looked at is because there is simply too much on trustee meeting agendas already. I do think there could be opportunities there. There could be merit in applying some sort of social overlay, but often trustee groups simply don't have the time to do it," Delo says. P

Meike Wijers is a freelance journalist

Keeping it real

Today's low interest-rate environment is a real challenge for pension schemes and insurers with burgeoning liabilities to match. The solution could lie in harvesting the illiquidity premiums offered by infrastructure and other real asset investments

In recent years, the tidal wave of liquidity set loose in pursuit of inflation-hedged assets has pushed government index-linked bond yields to distressing levels for those investors with longer-term liabilities to match. Those that bought 'linkers' early in the cycle have been well rewarded, but with real yields now in negative territory they offer little cheer to those responsible for overall portfolio returns. To add insult to injury, many pension schemes still face funding deficits while their scheme sponsors are increasingly anxious to insulate their balance sheets from the funding level volatility that accompanies conventional equity and bond investment. On the face of it, these liabilities and the attractive long-term index-linked income streams offered by infrastructure and other real asset subsectors of the US$33tn (£19.5tn) global commercial real estate market[1] would seem to be a match made in heaven. However, it hasn't been love at first sight.

Admittedly, real asset investments are relatively illiquid. But it's the illiquidity premiums they offer that account for their enhanced yields and the excellent risk-adjusted returns they can deliver (see chart 1).

Experienced managers are able to target returns of over 200 basis points above index-linked gilts (net of fees) for levels of risk that – thanks to robust government regulation – are much in line with investment grade credit. Considering that pension schemes, insurers, charities and sovereign wealth funds alike carry multi-decade liabilities that derive little benefit from holding liquid assets, this might not seem like a major hurdle. But, the course of true love never did run smooth.

Dead reckoning

While real assets can be used as both a substitute for, and a complement to, conventional inflation-linked and fixed-income assets, they also have another compelling trait. Namely, that most real asset investments can be structured to amortise. This means that investors enjoy an enhanced level of income while invested without a terminal 'balloon payment', as in the case of holding traditional bonds until maturity (see chart 2). Such payments present two distinct problems. The first is reinvestment risk – the very real prospect that in 20 years hence, there may no longer be suitable income-producing assets available for the risk required or that (like now) such assets are too expensive to be affordable.

The other is structural. For most institutions, the challenge is to invest their current assets to optimise the income they produce in the future. With this in mind, choosing to sacrifice potential yield in return for holding highly liquid assets for long periods and receiving a principal payment decades down the road (when inflation has eroded its value) would seem counterintuitive. This is especially so when considering that, by returning part of the investment principal each year, amortising investments also benefit from compounding.

Phil Ellis
Client investment director
Real estate

1 Source: DTZ May 2013

Chart 1

Chart 2

Searching for the real thing

However, some institutional investors remain reticent. While 30 per cent of European pension schemes have some allocation to real assets – mostly through conventional direct real estate holdings – the average allocation is a meagre 6 per cent[2]. When it comes to infrastructure investments, only around 5 per cent of schemes have made any investment in the sector, with the average allocation remaining at just 3 per cent. But with the UK government alone seeking £377bn to fund its National Infrastructure Plan, this is likely to change, and many schemes now express an intention to ratchet up their target allocations over the next five years. High lease-to-value or long lease property assets are also slowly gaining ground. So far, only around 4 per cent of schemes have invested in such assets, but average allocations here are estimated to be around 6 per cent[3]. Meanwhile, allocations to less high profile real asset classes such as real estate loans, commercial assets, ground rents or social housing are mostly too small to measure.

This is also something we expect to change as investors with liabilities to match slowly come round to the idea that, although they might look a little different, the long-term inflation-linked cash flows generated by real asset investments offer one of the best opportunities for pension schemes to improve their funding ratios and mitigate funding volatility.

Real options

In recent times, ambitious government spending plans have pushed infrastructure investment into the spotlight, but it's only one of numerous options. Although accessing some of these subsectors has been a hurdle in the past, this is no longer the case as more managers target some aspect of the real asset market.

Infrastructure investments

Infrastructure covers a hugely diverse and dynamic opportunity set spanning prestigious national infrastructure projects such as HS2 to bespoke carbon-efficient energy plants for hospital and university campuses, and everything in between. It's been estimated that the cost of financing the world's current infrastructure spending plans to 2030 will run to some US$57tn (£33.6tn)[4], with the great weight of this investment coming from the private sector.

2 Source: Mercer's European Asset Allocation Survey 2013
3 Source: S&P February 2014
4 Source: McKinsey & Co report, January 2013

Commercial assets

Commercial assets include properties as diverse as supermarkets, student accommodation, warehouses, educational facilities and car parks. By leasing such assets to local authorities or investment-grade tenants, managers in this space can deliver highly secure long-term income streams that are subject to upward-only rent reviews. As deals can be structured so that ownership of the asset passes to the tenant at the end of the lease, they can also be amortising. This means that returns of index-linked gilts +2 per cent can be achieved with relatively low levels of risk.

Ground rents

These are the rents that attach to residential or commercial freehold properties. Despite being a long-established part of real estate firmament, they have mostly been overlooked thanks to the low individual value of such leases. For example, residential ground rents are generally below 3 per cent of the capital value of the buildings on the land.

By carefully diversifying a portfolio, it is possible to generate a smoother, less stepped, index-linked return profile, with a strong correlation to inflation, but this requires large numbers of individual ground rent leases. Income security is especially high in this subsector, while ground rents are subject to upward-only reviews increasing in line with RPI or on a fixed uplift basis.

Social housing

Social housing refers to the residential properties owned by housing associations and local authorities. Currently there are around 1.7 million households in need of social housing in the UK[5]. By purchasing the freehold and then leasing such properties back to the registered providers for terms of 40-50 years, managers can access long-term inflation-linked income streams that are subject to upward-only review. As ownership of the assets passes to the housing authority at the end of the lease, such investments are fully amortising and, thanks to stiff regulation, default risks are very low.

Phil Ellis is client investment director, real estate at Aviva Investors

5 Source: Local authority housing statistics for England: 2012-2013, updated December 19 2013

Feature Case study

Avon links up with peers to gain exposure to infrastructure

Schemes joining forces can result in a wider range of investment options, although such an approach can also present dangers

Katrien Van Hoof

Avon Pension Fund is looking to invest £150m in infrastructure, in conjunction with other local authority funds.

The total size of the investment will be between £250m and £350m. "The main reasons for going into infrastructure are its inflation-linked nature, cash-generating properties and diversification of the portfolio," says the £3.3bn fund's assistant chief investment officer Matt Betts.

During the summer of 2013, the scheme reviewed its investment strategy, which led to a number of changes in its asset allocation.

The overall spread between growth and 'stabilising' assets remained the same, at 80 per cent and 20 per cent, respectively (see graphs).

It added a 10 per cent allocation to diversified growth at the cost of equities. Equities, which consisted of a UK and overseas portfolio, were divided into a developed market and emerging market equity allocation.

The final step was to fill the new 5 per cent allocation to infrastructure.

Over the past year, institutional investors have increasingly turned their attention to infrastructure to diversify their investment portfolios. However, the glare of the spotlight has exposed certain issues, particularly regarding the structure of investment funds.

In response, some schemes have started to look for alternative ways to invest. Avon joined forces with the £1.9bn Dorset County Council Pension Scheme and the £1.2bn Swansea City & Council Pension Fund to look for infrastructure managers. "The joint procurement brings down the cost of procurement, for starters," says Betts.

Each scheme will contract individually with selected managers, depending on their needs. There is a potential added perk of co-investing, because "if certain funds decide to invest with the same manager, we might have better negotiating powers regarding manager fees", he explains.

The main problem pension funds face in the infrastructure market is the way investment funds are structured, according to Adam Michaels, investment partner at consultancy LCP. He says: "Investors commit funds, but don't actually see what they are buying."

"There is a danger that asset managers who have a lot of committed capital to invest can lose their discipline and buy assets too expensively," Michaels says.

Additionally, infrastructure funds are often structured like private equity, which can lead to higher fees. Hymans Robertson's head of manager research John MacDonald says: "Returns from core infrastructure assets are relatively low, so it is often difficult to justify going down the fund of funds route."

Pooling investments is an effective way of reducing the high costs involved. MacDonald sees cooperation between several pension schemes or investments via the Pension Infrastructure Platform as a step in the right direction.

LCP's Michaels agrees: "Essentially, the Pip grew out of a group of pension schemes, which didn't like the typical fund structures and wanted to construct something better. So we're regarding this with a great deal of interest."

High fees and prices could potentially lead expected yields to evaporate, certainly now that infrastructure is a hot topic. Nevertheless, because it is linked to inflation and has a long-term horizon, infrastructure remains a viable alternative to low-yielding inflation-linked gilts.

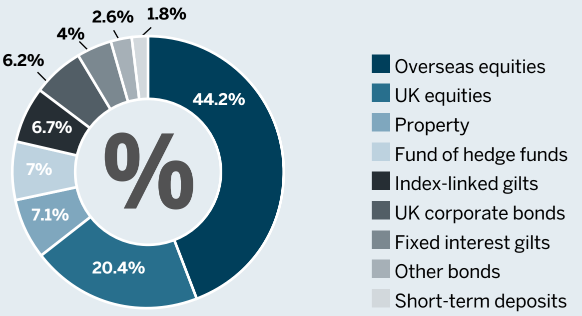
Managers who have a lot of committed capital to invest can lose their discipline and buy assets too expensively

Adam Michaels, LCP

Returns from core infrastructure assets are relatively low, so it is often difficult to justify going down the fund of funds route

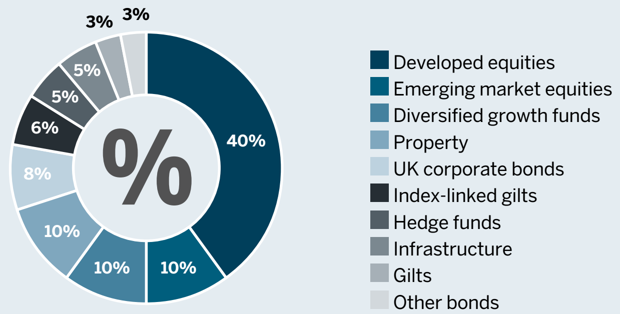
John MacDonald, Hymans Robertson

Avon asset allocation – March 2013



Source: Avon Pension Fund

Avon asset allocation – summer 2013 (following strategic review)



Source: Avon Pension Fund

"Another attractive way to access infrastructure is via a listed route, to invest in quoted equity of infrastructure companies," Michaels says. This type of investment gets around many of the negative aspects of the private equity structure. Funds can have a better insight into what's in their portfolio, the fees may be more reasonable and, importantly, they can exit more easily.

Hymans Robertson also finds direct infrastructure investment easier to recommend. MacDonald urged caution, though, as these assets are rather richly priced at the moment. "It is important to get a good price, because what funds pay at the outset defines what they will get at the end for core, operational infrastructure. And this is becoming increasingly difficult in the UK."

Furthermore, Michaels says listed infrastructure assets are more subject to the fluctuations of the stock market, adding that private equity-style vehicles may not be as stable as they seem.

"An area that is currently less developed is infrastructure debt funds, which could be ticking all the boxes for pension funds, especially if they are inflation-linked," he says.

A middle ground between the listed and unlisted vehicles is slowly emerging: the open-ended fund. It operates like a property fund, where investors can jump in and out fairly quickly, depending on illiquidity.

Both MacDonald and Michaels agree that the competition in the infrastructure market is good. Managers are pushed to do better as schemes, like the Avon Pension Fund, look for alternative ways to gain exposure. P

Katrien Van Hoof is a reporter at Financial Times service MandateWire Europe

Case study
The Pip structure

In February, the National Association of Pension Funds spelled out the essentials of the Pensions Infrastructure Platform.

The initiative was originally launched by the NAPF and the Pension Protection Fund in late 2011 to create a low-risk, low-cost infrastructure investment vehicle that would provide the long-term, stable returns needed by schemes.

The first £260m from the founding members was invested with asset manager Dalmore Capital, and further fundraising from other schemes has started.

Strathclyde Pension Fund, one of the first investors, approved £50m to be invested in Pip.

Details released by Strathclyde show the platform's equity fund will invest primarily in the secondary public-private partnerships in areas such as health, education and transport.

The fund might also invest in 'Private Finance 2' structures at the construction phase of healthcare, education or transport projects.

There is also an option to invest a small proportion in ungeared PPPs or solar projects, which can offer inflation linkage.

The fund has a target return of RPI plus 4-5 per cent and "was projected to generate an acceptable level of return with high correlation with inflation over a 25-year period", according to a report from the fund approving the mandate.

However, three major schemes pulled out of the platform after details of the investments were outlined. The NAPF confirmed these were telecoms giant BT, defence company BAE Systems, and local authority scheme the London Pensions Fund Authority.

In a statement, the LPFA said: "It became clear that the pricing and risk-return profile, as well as other aspects of the Pip cost structure, differ from those now required by the LPFA."

The remaining investors are Strathclyde, West Midlands Pension Fund, Railways Pension Scheme, British Airways Pension Scheme, the Lloyds Pension Fund, the PPF and an anonymous fund.

Bridging the gap

Hermes discusses the opportunities for alternative lenders in UK real estate debt as markets continue to evolve

Following the global financial crisis, the tide went out on commercial property lending by banks. It has yet to come back in, and arguably will stay that way. Rather than simply leaving borrowers high and dry, this withdrawal has left behind it attractive opportunities for alternative lenders.

Launched last December, the Hermes Real Estate Senior Debt fund offers exposure to this asset class, bringing Hermes' structuring and underwriting, real estate and fixed income expertise together to access this opportunity.

The fund offers secure income from a portfolio of UK commercial property loans. Loans are made to strong borrowers and secured against high-quality income-producing assets that offer strong tenant quality, demand and diversification.

Changing market fundamentals

Debt was at the heart of the crisis in 2007 and 2008. Real estate markets that had been buoyed by excessive levels of debt have suffered the consequences.

Some six years on, the UK's commercial real estate (CRE) values have recovered only 22 per cent since their peak-to-trough decline of 42 per cent. These falls in capital values have left many banks exposed to underperforming loans, loans in breach and with significant concerns over refinancing risk.

Today, UK banks continue to fight an uphill battle to repair their loan books while meeting the demands of a recovering economy and real estate market. Meanwhile, borrower requirements are on a rising trend and this will be reinforced as the economic and market recovery becomes more established.

This makes the risk-reward profile of investing in senior real estate debt very attractive for investors, and particularly attractive to those looking for a large allocation to fixed income-like investments that provide a stable cash flow.

Senior debt today typically comprises real estate loans between 50-60 per cent and up to 65 per cent loan-to-value (LTV) – equivalent to A-rated bonds risk. The reluctance of banks to underwrite CRE loans of more than £30m, affords an excellent opportunity to provide larger-ticket senior debt loans secured on high-quality, well-located property.

And the loan demand is there: Hermes Real Estate Senior Debt portfolio managers have a pipeline of potential transactions of quality commercial properties, both in London and the regions. Sifting the wheat from the chaff, however, takes experience and the ability to do the necessary on-the-ground due diligence. The structuring and underwriting expertise of the Hermes Debt team and expert external valuation and legal advice underpin a robust investment process. The aim is to deliver a diversified portfolio by borrower, number of loans, underlying assets, tenant covenants and loan maturities.

This strategy is rooted in a recognition that the UK's real estate debt market is going through fundamental change, creating opportunities for lenders and borrowers alike. While LTVs have fallen since 2008, loan margins have risen considerably and the typical margins for senior debt are now at very attractive levels. Asset swap spreads over Libor remain 1-1.5 per cent above similar quality corporate bonds, offer better

> "New entrants with capital are combining in-depth real estate expertise alongside financial and real estate debt skills to build sustainable offerings

capital protection than both the latter and real estate equity, and with lower volatility.

The requirement for commercial real estate debt will increase as the UK's real estate market gathers momentum in recovery.

Loan Britannia

The UK is one of the most attractive markets for alternative lenders. It is one of the most structurally undersupplied markets, with a refinancing gap second only to Japan's. There is a trend towards larger deal sizes. This is why many consider the UK to be the most attractive market for debt funds. The UK is also attractive to lenders from a legal perspective, with a long-established administrative system, enforcement process, transparency and historic liquidity. For example, in the event of a loan default, lenders can accelerate loans and appoint enforcement receivers to facilitate repayment of the loan.

The opportunity for new entrants is significant. There are few large institutions beyond banks that are able to fulfil the role of credible players in this market, and it is this supply constraint that has shifted the risk-return profile of the asset class in lenders' favour. What's more, as we indicated at the start, this change in the real estate debt markets is structural. It will therefore be long term, and we see potential for a prolonged mismatch between the requirements of commercial real estate borrowers and the objectives of the debt providers as they adjust to the new market norms.

Characteristics

While real estate debt is likely to be modestly correlated with fixed income instruments, the returns compared with equivalent credit returns are attractive. Real estate debt offers a strong alternative for institutional investors seeking income.

What's more, floating rate debt – which is how this tends to be written – is a natural hedge against rising interest rates. This is particularly attractive in an environment of historically low rates.

The protection offered by reasonable senior debt LTVs and seniority in a borrower's capital structure makes this a low-risk, low-correlated, portfolio diversifier. It has an attractive risk-return profile when compared with equivalent, A-rated, corporate bonds. Like any debt instrument, however, there is of course a default risk – again, equivalent to A-rated bonds.

New entrants with capital are combining in-depth real estate expertise alongside their financial and real estate debt skills to build sustainable offerings to investors and borrowers. Many will become established players within the decade and provide an established alternative to banks as a funding source for real estate debt.

During this period there will be increasing opportunities for debt providers in the UK who can underwrite effectively supported by in-depth appreciation of the real estate fundamentals that ultimately underpin the debt instruments, to generate a range of attractive risk-adjusted returns. All the more important, then, for those interested in investing in this asset class to have a good appreciation of the skillset needed to manage it effectively.

Finding the right manager

Management of senior debt requires both real estate and fixed income expertise, particularly the specific skills appropriate to the underlying portfolio of assets and to be able to continually service that portfolio.

Effective origination capability is vital, and investors should identify managers that can demonstrate a record of delivering this. Lastly, in order to take advantage of the current opportunity in £30m to £100m loans, the investment manager should have the necessary capacity to service this area of the market. As such, the Hermes Real Estate Senior Debt fund focuses on this sweet spot between £30m and £100m.

Loans in the portfolio are floating rate to offer a degree of interest rate protection. They will be made to strong borrowers and secured against high-quality income-producing assets that offer strong tenant quality, demand and diversification. LTVs are capped at 65 per cent for individual loans and 60 per cent across the portfolio, offering the significant risk cushion in the event of falling asset prices.

Lastly, though importantly, the fund's asset base is designed to have a low correlation to traditional asset classes, so providing investors with an additional degree of security.

For more information contact James Lucas on +44 20 7702 6169 or j.lucas@hermes.co.uk

Feature Analysis

DC schemes and the real asset market must work together

Will the recent changes to annuities prove a barrier for schemes to invest in real assets?

Tom Dines

Interest in real assets has been growing among UK defined contribution schemes, but many say changes to the regulatory landscape and culture of the industry are needed before they can become a mainstream option.

The use of real assets such as property, infrastructure and timber can provide both defined benefit and DC schemes with inflation-linked returns.

But challenges in both liquidity and scale have so far thwarted attempts to make the assets viable for smaller DC schemes without the ability to afford the often expensive fund management fees.

Pensions Infrastructure Platform

Perhaps the most prominent recent attempt to encourage schemes to invest in real assets is the Pensions Infrastructure Platform.

Though it is predominantly DB, DC schemes and providers Nest and Scottish Life have been courting the platform.

Pip was created in 2011 to help schemes take advantage of economies of scale to access UK infrastructure, but it has faced criticism over delays and the recent withdrawal of three major founding investors.

Many experts say delays in DC infrastructure uptake have more to do with the structure of the UK market, which is still immature compared with countries such as Australia.

"The UK is really only starting to address the issue of having lots of fragmented smaller schemes," says Robin Miller, global head of debt at fund manager IFM, which is headquartered in Australia. Currently, only some of the practicalities are in place, but "the ideals are there", he adds.

One such practicality is the increased at-retirement flexibility for DC members, announced by chancellor George Osborne in this year's Budget. Miller argues that the removal of the restriction to annuitise may make it more difficult for schemes to collaborate.

"The only way you can do it is in large pooled management funds," he says. "The general makeup of the UK market, to my knowledge, goes against that – it's hard to get an alignment among a disparate pool of pension funds. Scale matters, as does the ability to pool."

Increased flexibility

Miller's concern is echoed by Mark Fawcett, chief investment officer at state-sponsored mastertrust Nest.

"Increased flexibility [from the Budget] will allow people to take cash out, so funds will need to bear that in mind," says Fawcett. "They shouldn't overexpose themselves to illiquid assets."

Despite this, the flexibility increases the scope for innovation, including by allowing pensioners to remain invested into their retirement. This would reduce the need for liquidity.

"We're consulting on the scope for people to be investing through retirement… keep some risk on the table and be exposed to growth assets," says Fawcett. "Potentially, they can be invested in real assets for longer – the Budget opens up the possibility for a lot of different products."

Nest has an allocation to real assets comprised mainly of property investments, though Fawcett says it is looking to increase its infrastructure holding.

"We already have investment in UK commercial property," he says.

Using a combination of direct property investment and real estate investment trusts allows the mastertrust to manage illiquidity, as money moves into

It's hard to get an alignment among a disparate pool of pension funds

Robin Miller, IFM

Trying to impose private equity charges on low risk doesn't really make sense

Mike Fawcett, Nest

Real assets such as infrastructure have been difficult to access in DC schemes

the Reit until a direct investment is found that matches the risk-return profile required by the scheme.

"At some point we'll have several billion [pounds] coming in – you can't always put that straight into the direct investment. The Reits act as a cushion," says Fawcett.

This approach is usually suited to schemes with a target-date structure, as illiquid assets can be passed down through target-date funds as members are derisked and eventually retire.

The mastertrust is looking to take a similar approach with its burgeoning infrastructure allocation, says Fawcett.

Adapting for DC

Crispin Lace, director of consulting and advisory services in the consultancy team at fund manager Russell Investments, says the changes needed to make real assets viable for DC seem to be coming through.

The emergence of mastertrusts has led to greater use of diversified growth funds, which is a rapidly growing sector of the market.

"What you're seeing is a growing use of real assets within diversified growth vehicles," says Lace, who adds that schemes have to be more willing to make use of wrap-like investments.

Auto-enrolment may also feed into real assets investment, as DC schemes increase in size and scale.

"We're seeing all the right changes come through," Lace says. "I'm pretty optimistic about the space."

He adds: "The world has recognised that these are a great opportunity, but there needs to be a good governance structure in place."

Infrastructure assets are traditionally the preserve of DB schemes and the market will have to adapt if it is to become accessible to DC schemes.

"The infrastructure fund management industry hasn't designed itself to be DC friendly yet," Fawcett says. "We're trying to encourage them.

"Quite a few infrastructure managers are trying to charge 1.5 per cent and performance fees on top – those charging structures are a real challenge. We don't think they deliver good value for our members."

The range of risk and return profiles on offer within the infrastructure space make it a versatile asset for investors, but also makes expensive charging structures difficult to justify.

"The returns differ significantly and trying to impose private equity charges on low risk doesn't really make sense," Fawcett observes. P

Tom Dines is a reporter at Pensions Expert