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# Local authority pension fund investment since the financial crisis

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In this Brief, the Sheffield Political Economy Research Institute (SPERI) presents evidence on asset allocations by local authority pension funds in the UK, based on annual data published by funds. It charts in particular the changes in investment patterns evident since the 2007/08 financial crisis, and the extent of moves towards 'alternative' investments such as infrastructure. This analysis will shortly be supplemented by a further Brief which assesses the strategic decision-making of local authority pension funds; that is, the rationale behind some of the changes documented in this Brief.

## Background

- In most private sector defined benefit pension funds, investment strategies have generally become more conservative since the financial crisis, with funds moving out of equities, and into gilts. Whether local authority pension funds (which are also defined benefit funds) have replicated this change is less well-known.
- Local authority pension funds hold assets worth more than £200 billion. The largest of these funds are among the largest institutional investors in the UK.
- Whereas private sector funds are generally being replaced by individualised defined contribution schemes, local authorities remain committed to the collectivised defined benefit model.
- However, local authority funds are experiencing some of the same problems as those in the private sector, with demographic change increasing liabilities, a difficult environment for investment returns and declining active memberships due to the impact of severe impact of cuts in public expenditure on recruitment within the local government sector.
- As Chancellor of the Exchequer, George Osborne advanced proposals for the merger of all local authority funds into six 'mega funds', designed to enhance funds' capacities to invest in long-term assets such as physical infrastructure. Of course, the largest funds are already the product of mergers, with many funds encompassing the pension schemes of several local authorities within a region.
- Accordingly, many stakeholders associated with local authority pension funds have expressed an interest in increasing investment in assets such as infrastructure. There has as yet been little research into whether this agenda has had a material impact on fund allocations.
- The research presented in this Brief is part of a larger study into the possibility of public and private sector pension schemes 'localising' their investment strategies. It is impossible to deduce the extent of local investments from the available data, but this Brief establishes the context in which localisation may occur.

## Evidence

- This section presents evidence on the asset allocation of local authority pension funds between 2005 and 2016, based primarily upon annual fund reports.
- The section begins, however, by detailing average asset allocations within the closest comparator group, that is, private sector defined benefit funds.
- It is worth noting that there is no standardised form of reporting by pension funds regarding asset allocation; the Pension Protection Fund's annual Purple Book publication standardises reporting in the private sector to some extent – but sacrifices a degree of detail in doing so.

- Among local authority pension funds, there is a lack of uniformity around whether assets such as infrastructure are an asset class in their own right, or instead included in 'other' or 'alternative' categories.
- There are a large number of local authority pension funds, but they vary considerably in size; in part due to some covering several local authorities within a metropolitan area. Our analysis distinguishes between all local authority pension funds and the 25 largest funds. (Data on approximately 100 funds are available on the Local Government Pension Scheme Advisory Board website; see <http://lgpsboard.org/>).
- Tables 1-3 show the average allocation levels for private sector defined benefit funds, all local authorities pension funds, and the largest 25 local authority pension funds.

**Table 1: Private sector defined benefit funds asset allocation, 2006-2016 (%)**

	2006	2009	2013	2016
Equities	52.6	46.6	40.6	36.8
<i>of which: UK</i>	-	26.8	19.3	14.3
<i>of which: overseas</i>	-	19.4	20.4	21.6
Bonds	22.6	29.2	39.1	41.1
Cash	3.9	5.6	6.2	5.4
Property	2.1	2.8	3.6	3.7
Alternative (including infrastructure, private equity and hedge funds)	-	3.3	8.5	11.8
<i>of which: hedge funds</i>	-	0.7	5.0	7.9
Other	-	12.5	2.0	1.2

Source: PPF Purple Book (various editions), available at <http://www.pensionprotectionfund.org.uk/Pages/ThePurpleBook.aspx>  
 Note: figures refer to the average allocation level across all schemes included

**Table 2: Local authority pension fund asset allocation, 2005-2016 (%)**

	2005	2009	2013	2016
Equities	71	53	58	53
<i>of which: UK</i>	39	26	24	20
<i>of which: overseas</i>	32	27	33	33
Bonds	18	35	18	16
Cash	4	3	3	3
Property	7	6	7	9
Alternative (including infrastructure, private equity and hedge funds)	-	5	7.5	8.7

Source: Authors' calculations based on all funds' annual reports  
 Note: figures refer to the average allocation level across all schemes included

**Table 3: Local authority pension fund asset allocation, 2005-2016 (Largest 25 funds; %)**

	2005	2009	2013	2016
Equities	62	56	47	53
<i>of which: UK</i>	35	28	16	18
<i>of which: overseas</i>	27	29	31	35
Bonds	13	16	19	16
Cash	5	5	3	3
Property	10	7	9	9
Alternative	11	16	23	19
<i>of which: infrastructure</i>	1	1	4	4
<i>of which: private equity</i>	2	3	6	5
<i>of which: other (including hedge funds)</i>	7	12	13	9

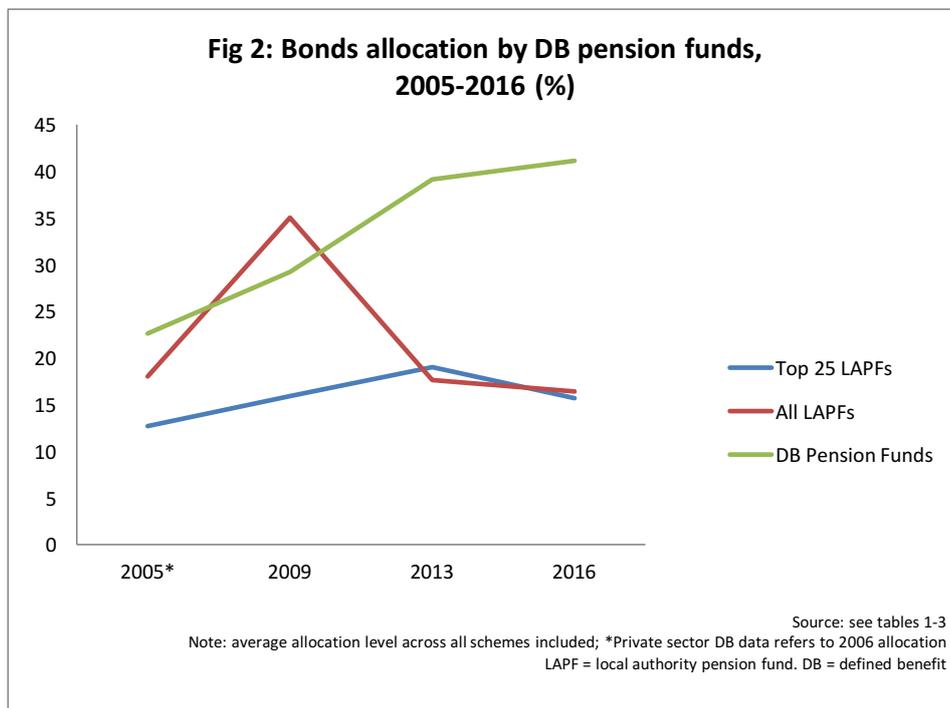
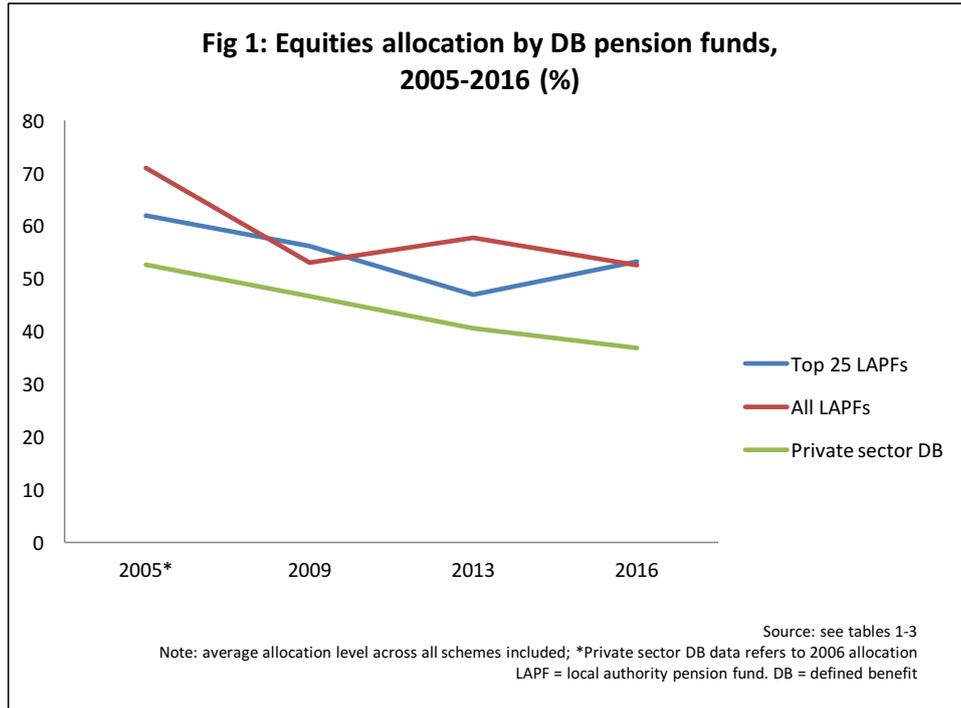
Source: Authors' calculations based on annual reports of the 25 largest funds (as of March 2016)  
Note: figures refer to the average allocation level across all schemes included

## Equities

- As shown in Figure 1, the most important recent development within private sector defined benefit fund investments is the move away from equities, which is steeper and steadier than the trend evident in local authority pension funds.
- As Table 1 shows, this change is based mainly on a move away from *UK* equities. The average allocations across private sector funds has declined by more than 12 percentage points since 2009, compared to a small rise in allocations to *overseas* equities. This trend is only partially explained by recent changes in the value of UK equities.
- Local authority pension funds have also moved sharply away from UK equities, and more firmly towards overseas equities. This is especially the case, on both counts, for the largest funds – the average allocation to UK equities has halved to 18 per cent, while the allocation to overseas equities has increased from 27 to 35 per cent.

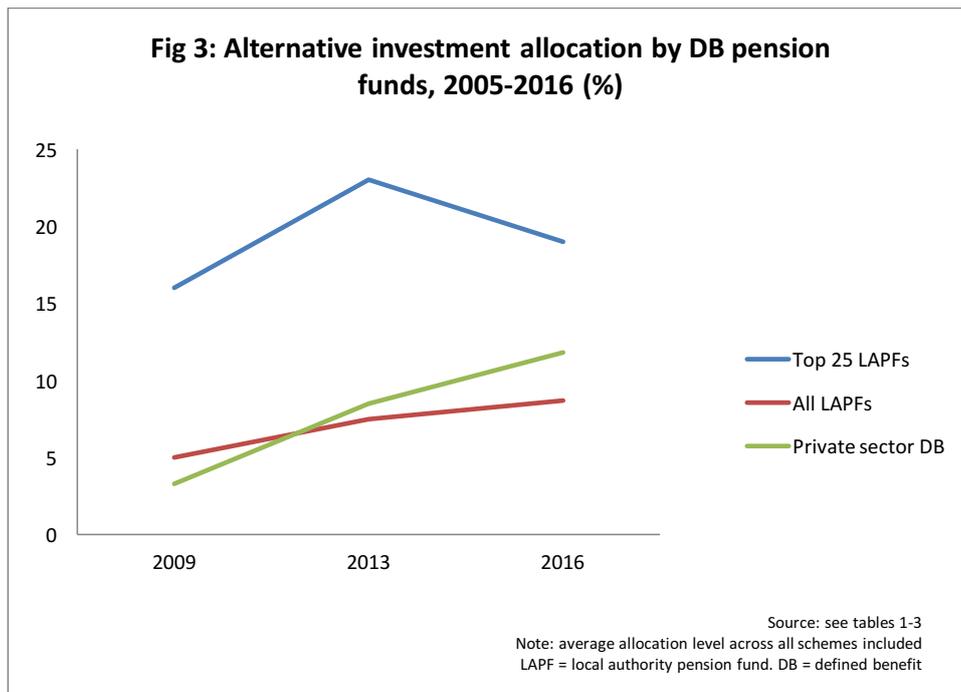
## Bonds

- Generally speaking, the flipside of 'de-equitisation' is of course the move into more secure (but lower return) assets such as bonds, primarily gilts. As shown in Figure 2, the average allocation of private sector defined benefit funds to bonds rose from 23 to 41 per cent between 2006 and 2016.
- This trend, however, is not at all evident in local authority pension fund investments. Among all schemes, there was an immediate move into bonds in 2009 after the financial crisis, but this has now been reversed. The average allocation to bonds is now 16 per cent, below the figure for 2005.
- Among the largest local authority funds, there is no evidence even of this initial shift, although the average allocation did increase from 13 to 16 per cent over this period.



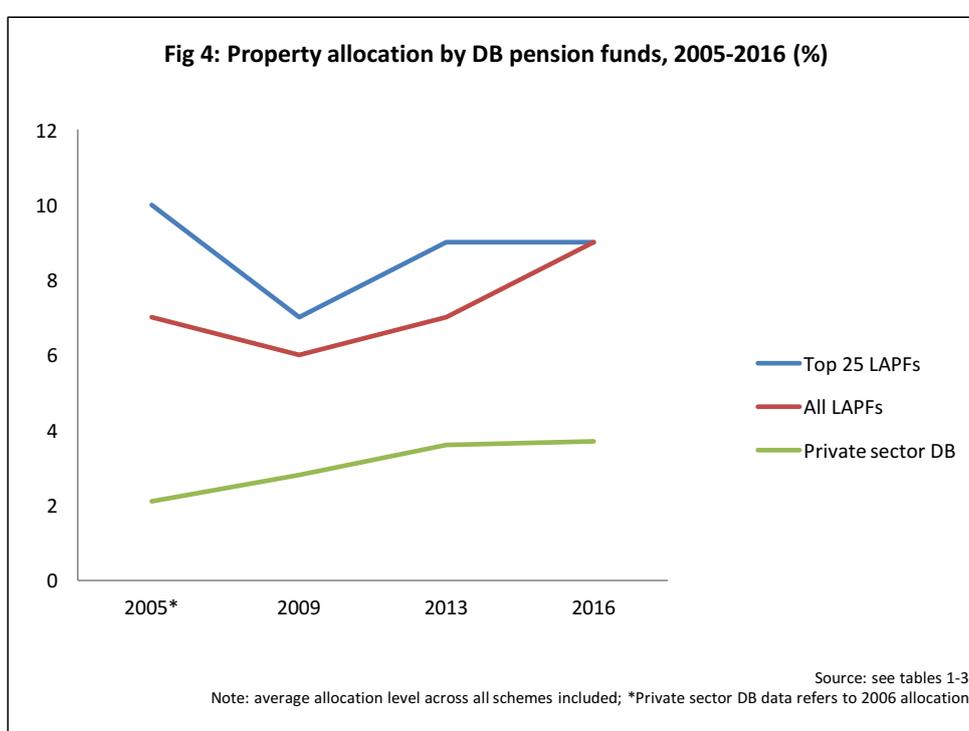
## Alternative investments

- As shown in Figure 3, private sector and local authority funds are now allocating a larger portion of their funds to 'alternative' asset classes. In general, local authority funds are more willing to invest in alternative assets as they diversify, to some extent, having not moved firmly into bonds since the financial crisis.
- Interestingly, however, the allocation for the largest local authority funds fell between 2013 and 2016, from 23 to 19 per cent.
- Among the largest local authority funds, there has been a quadrupling of the average allocation to infrastructure between 2005 and 2016. However, this increase began from a very low base (1 per cent in 2005, now 4 per cent).
- It is not possible to disaggregate specific allocations to infrastructure within the private sector, or local authority funds in general, due to inconsistent reporting. The patchy and inconsistent nature of the data on alternative investments more generally means a degree of caution is required when using the evidence presented in the Brief in this regard.



## Property

- The property asset class is probably the best proxy we have for *local* investments, since direct investments in property by local authority funds seem to be more likely to be located within their own localities.
- However, relatively little can be inferred from this evidence regarding property investment. There are, again, issues around the reporting and definitions of property investment which means this data must be used cautiously.
- This caveat notwithstanding, private sector and local authority funds appear to be more willing to invest directly in property-based assets. The largest local authority funds are the most willing to do so, but have recently reduced their exposure to property (see Figure 4).



## Analysis and conclusions

It is clear that local authority pension funds have not demonstrated the same degree of conservatism in their investment strategies as private sector defined benefit funds since the financial crisis. They have de-equitised to some extent, but not moved into bonds, and appear more willing to invest in alternative assets. The largest funds in particular have demonstrated an interest in infrastructure investments – while in the private sector, the move to alternative assets is largely explained by increased hedge fund investments. Partly because of limitations in the data and fund reporting, it is difficult to discern any particular interest in investing directly in the local economies within which the local authorities (or more appropriately, the local authority employees whose savings make up the funds) are situated.

While there is probably scope for local authority funds to invest more in less conventional and riskier asset classes, including reorienting their investment to their localities to some extent, we should not assume that local authority pension funds are immune from the kind of economic and demographic pressures which have driven conservatism among private sector funds. A genuine transformation in the way pension funds in the UK invest may require us, therefore, to concentrate instead on the new individualised defined contribution schemes in the private sector, which currently have much younger memberships.

That said, the nature of individualised pensions saving may make it even more difficult to increase exposure to riskier assets, since members are much less able to share investment risks with their employer, or even other members of the scheme. As such, barring significant reform of defined contribution pensions saving vehicles, local authority pension funds will for the foreseeable future be seen as one of most important sources of long-term investment in the UK, and will continue to be seen as a (potential) source of capital for locally-oriented investment. Yet the policies and practices which might enhance local authority pension funds' capacity in this regard remain under-developed.



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