Update on Schroder Real Estate Capital Partners

This paper is addressed to the Officers and Pension Committee ("the Committee") of the East Sussex Pension Fund ("the Fund"). The purpose of this note is to comment on recent developments within Schroder's, the Fund's property manager, indirect property investment management business. It should not be released or otherwise disclosed to any third party except as required by law or regulatory obligation or without our written consent. We accept no liability where the paper is used by, or released or otherwise disclosed to a third party unless we have expressly accepted such liability in writing.

Background

The Fund currently has a target allocation of 10% of assets to property. At present, the Fund has £321m, equivalent to around 12.3% of assets, invested in a mandate managed by Schroder on a segregated multi-manager basis. Schroder's objective is to outperform the AREF/IPD UK All Balanced Funds Index by 0.75% p.a. (net of fees).

Details of Schroder's performance are provided below. As shown, the manager has outperformed over one, three and five years, achieving the outperformance target over three years (but not one and five).

	12 months	3 years (p.a.)	5 years (p.a.)
Total portfolio	14.7%	13.0%	9.8%
Benchmark	14.4%	11.7%	9.0%

Note: Total portfolio returns are gross of fees. Current fees for the Schroder mandate are 0.2% p.a. Performance to 30 September 2015

In the remainder of this paper we provide an update on Schroder's property team ("RECaP" – Schroder Real Estate Capital Partners) and state our latest view on the manager.

Recent changes

Over the last three months, Schroder has experienced considerable changes in the people within the business, prompting it to change how it resources the RECaP business.

- In July 2015, Jennifer Murray left Schroder following an internal review of the RECaP business. Schroder cited various reasons for this change, particularly the changing nature of its business, the skill sets necessary for this and the overall lower workload that has ensued. It was envisaged that Murray's responsibilities would be split between Graeme Rutter and Tony Doherty, the two senior investors within the business (Rutter is the named manager of the Fund's mandate).
- In August 2015, Tony Doherty resigned from the team to take up a position with LGIM. We understand that this was completely unexpected given the previous change. However, Doherty's resignation placed a significant resource constraint on Schroder.
- Keeran Kang, a junior fund manager, has subsequently advised Schroder of her intention to leave the business, this being for personal reasons.

Schroder has sought to emphasise that the reasons for the three departures are not related and not driven by some underlying issue with the business, given each has left/will be leaving for substantially different reasons. We have no reason to dispute this albeit it these changes have created an immediate resourcing strain and hence increased the risk to client portfolios.

Schroder response

Schroder's immediate need has been to address the lack of senior resource within the RECaP business. It has chosen to do this by utilising internal resource. Specifically, Neil Turner is moving into the RECaP business. Turner has, since 2013, been Head of Indirect Investment and Research, with overall responsibility for both listed and unlisted strategies.

Turner has also had more "hands-on" experience of the business, having been originally involved in the development of the multi-manager business in 2005, working alongside the then Head of Multi-Manager, Jenny Buck. Turner currently also chairs the indirect investment committee and hence has knowledge of portfolio strategy although he does not yet have the detailed knowledge of the underlying vehicles.

Schroder has also sought to broaden the role of the remaining members of the team. Patrick Bone and Gianlorenzo Polella, who both have 8 years investment experience, are to be given fund management responsibilities. This effectively secures a promotion from the Senior Analyst roles that they have held until now, reflecting a desire to provide career progression within the business. Whilst the departure of Doherty has been the catalyst for this change, it seems sensible. Schroder did consider recruiting externally for the fund manager role, but making use of internal resource was regarded as a preferable option.

These changes do however leave gaps within the analyst team. Schroder is addressing this in two ways:

- First, Schroder is recruiting for Senior and Junior Analyst roles, noting that the analyst responsibilities will become a more distinct career path, akin to what it currently has in place in its listed real estate business.
- Second, Jeremy Marsh, currently Head of UK Real Estate Research, will transfer to the RECaP team to provide senior analyst support. It is likely that this will be on an interim basis.

Schroder has advised that they are currently interviewing for the Senior Analyst position.

Hymans Robertson View

With a relatively small team, it is clear that any loss of personnel would place a strain on the ongoing operation of the business. Whilst we accepted that the departure of Murray, driven by an internal restructuring, was acceptable, we highlighted the risk to the business that a future departure would cause. We did not expect this risk to transpire so quickly

The team changes proposed by Schroder as outlined in this note seem to be a sensible reaction to the resignation of Tony Doherty. Whilst Doherty's departure has been a clear catalyst for a change in structure, Schroder notes that the career analyst model it is seeking to implement is already in place within its listed real estate business.

By drawing on an existing resource, particularly one with relevant experience as Turner can demonstrate, Schroder is able to mitigate the delay that would otherwise have resulted from a recruitment process. As Turner has existing knowledge of the processes employed within Schroder, his learning curve will be focused on client portfolios and the detail of the underlying funds, something that can begin immediately.

<u>Given the underlying illiquidity of the assets – indirect property portfolios do not change quickly – we believe that the risk to clients arising from these changes is relatively low. Although we have downgraded our rating of Schroder's indirect property management capabilities to "3: On Watch", we do not believe investors should overreact and therefore we recommend that you should retain the manager at this time.</u>

We will be meeting with all members of the property team over coming months and will review this rating early in 2016 once Schroder completes its recruitment process. We will keep you update on developments and the finding of this research.

We look forward to discussing this paper with you in the near future.

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September 2015 For and on behalf of Hymans Robertson LLP

General Risk Warning

Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets.

Exchange rates may also affect the value of an overseas investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.