

Pension Fund Committee

Meeting to be held on Friday, 8 June 2018

| |
|---------------------------------------|
| Electoral Division affected: None; |
|---------------------------------------|

2017/18 Full year budget monitoring report

(Appendix 'A' refers)

Contact for further information:

Abigail Leech, Head of Fund abigail.leech@lancashire.gov.uk

Executive Summary

This reports sets out the income and expenditure of the Fund for the year from 1 April 2017 to 31 March 2018 with comparison to the budget for the same period.

Recommendation

The Committee is asked to consider and note the analysis of variances between actual and budgeted financial results for the year ended 31 March 2018.

Background and Advice

The 2017/18 budget is a key tool for monitoring the financial performance of the Fund, and in particular the achievement of planned savings through LPP.

The one year budget for the year ending 31 March 2018 was approved by the Pension Fund Committee at its meeting on 17 March 2017.

It was noted in the report to Committee in March 2017 that it is difficult to estimate income due to the Fund and costs associated with the investment activities of the Fund with any degree of accuracy but it was agreed that a quarterly review of variances against the budget would provide useful management information for the monitoring of the financial position of the Fund.

Referring to the key income and expenditure items outlined in the budget, a comparison of actual results to budget is set out below. Further information is set out at Appendix 'A'.

INCOME

Contribution income

- **Full year budget £246.5m, full year actual £237.9m**

Contributions include income from both members and employers. It covers regular and additional contributions including deficit contributions from employers.

A favourable variance of £8.2m in employer regular contributions is offset by lower than budgeted pension strain income from employers (£10.8m variance) and a shortfall in employer deficit contributions compared to budget (£5.8m).

Actual deficit contributions are £5.8m less than budget. The actual deficit contributions are in line with the final valuation results after taking into account amended recovery periods and discounts for prepayment.

Contribution income from employees is £0.2m below budget.

Transfers in

- **Full year budget £6.7m, full year actual £11.5m**

The budget for transfers in is based upon average income over the previous two years and an assumption that the income will begin to reduce in line with the number of employees within the member organisations.

Actual transfers in during the year to 31 March 2018 exceeded budget by £4.8m. This can be explained, in part, by the increase in active membership but as noted in previous monitoring reports, it is difficult to forecast this income with any degree of accuracy.

Investment income

- **Full year budget £109.2m, full year actual £142.0m**

A £37.0m favourable variance against budget for income from pooled investments is offset in part by a shortfall in income from other categories of investment (£2.6m) and foreign exchange movements (£1.6m).

Income from pooled investments includes £54.7m dividends from pooled equity funds which are reinvested. The income is reported in the fund account but the overall impact on the bottom line is nil as the reinvestment of the income is reflected in the net asset value of the pool.

EXPENDITURE

Benefits payable

- **Full year budget £254.6m, full year actual £254.8m**

The net budget overspend of £0.2m is the result of a £4.8m adverse variance on pensions paid against a favourable variance of £4.6m in lump sum benefits paid during the year. A full year saving of £2.3m on benefits payable was forecast in the December monitoring report but additional lump sum benefits paid in the final quarter of the year have eliminated this potential underspend.

Transfers out

- **Full year budget £13.8m, full year actual £17.4m**

The full year variance against budget is in line with the forecast reported to committee in March. Transfers out, like transfers in, are difficult to accurately forecast and are a function of membership and individual employees.

Administrative expenses

- **Full year budget £3.7m, full year actual £3.8m**

The £0.1m variance in administrative expenses represents additional costs paid to LPP for the pension administration service.

Investment management expenses

- **Full year budget £34.0m, full year actual £52.2m**

Initial guidance for transparent reporting of investment costs was issued by CIPFA in 2014 and the Lancashire Fund has been following the guidance since then. Updated guidance was issued in 2016.

The Fund is subject to both directly invoiced management fees and also fees which are netted off against the value of investments held on the net asset statement. The guidance requires all fees to be reported through the fund account and the value of investments to be 'grossed up' to eliminate the impact of these fees on asset value.

Since setting the budget for the year, and as more investment managers (including LPP) sign up to the transparency code, the availability of information regarding non-invoiced fees has increased. As a result the actual costs for the year include fees which were not recognised in the budget – for example, fees relating to investments in private equity.

The current budget monitoring position indicates an increase in expenses of £18.2m. At the time of writing, approximately £10m overspend can be attributed to private equity fees not included in the budget. These figures are under review and the remaining variance is considered likely to be the result of greater transparency of fee reporting in the current year. The draft figures will change before the final accounts are signed and the annual report published.

A detailed review of investment management fees is ongoing and final figures for publication will be presented to the committee in July.

Oversight and governance costs

- **Full year budget £8.3m, full year actual £8.0m**

£8.0m for oversight and governance costs include £3.3m property expenses which are netted off investment income for statutory reporting purposes in the annual report.

Property expenses are in excess of budget by £0.8m. These costs are offset by reduced expenditure on advisory, legal and professional fees and by a saving against the budget for LCC recharges.

Net surplus before realised and unrealised profits on investments

- **Full year budget £47.4m, full year actual £54.6m**

The net surplus of £54.6m for the full year to 31 March 2018 does not equate to additional cash or profit available to the Fund. It is the surplus of income over expenditure from an accounting perspective, before recognising the change in market value of investments held. The overall increase in the value of the Fund during the year to 31 March 2018 is £274.9m and this is reported in the draft accounts of the Fund which will be available for public inspection from 1 June.

The fund is 'cash flow negative' before accounting for investment income and changes in market value of investments. As detailed in the above narrative, benefit payable (including transfers out and refunds of contributions) amount to £272.7m and are partly funded for the year by contributions of £237.9m and transfers in of £11.5m.

The resulting net cash outflow from these transactions with members, together with administrative, investment management, oversight and governance costs is funded by investment income.

Consultations

Variances between actual results and budget, where relevant to LPP, have been discussed with the LPP finance team as appropriate.

Implications:

This item has the following implications, as indicated:

Risk management

Regular monitoring against the budget of the fund will provide an explanation of key variances and informs future budget setting and forecasting. The actual results for the year to 31 March 2018 and the variances from the budget for the same period

have been considered in setting the 2018/19 budget and in particular the increased transparency of fee reporting has been assumed to continue.

Local Government (Access to Information) Act 1985
List of Background Papers

| Paper | Date | Contact/Tel |
|-------|------|-------------|
|-------|------|-------------|

| | | |
|-----|--|--|
| N/A | | |
|-----|--|--|

| |
|---|
| Reason for inclusion in Part II, if appropriate |
|---|

| |
|-----|
| N/A |
|-----|