Pension Fund Committee
Meeting to be held on Friday, 30 November 2018

Electoral Division affected: None;

Lancashire County Pension Fund - Q2 Budget Monitoring
(Appendix A refers)

Contact for further information: Abigail Leech, Head of Fund, Lancashire County Pension Fund, Abigail.leech@lancashire.gov.uk

Executive Summary

This reports sets out the financial results of the Fund for the period 1st April to 30th September 2018 and compares those results to the agreed budget for the same period.

A forecast for the whole year is included, which is updated on a quarterly basis.

Recommendation

The Committee is asked to consider and note the variances between actual and budgeted results for the six months to 30th September 2018 and also the forecast financial results for the year ending 31st March 2019.

Background and Advice

The budget for the year ending 31st March 2019 was approved by the Committee on the 8th June 2018.

It is difficult to accurately estimate income due to the Fund and any costs associated with investment activities but it is considered essential to have an agreed budget each year to form the foundation for financial monitoring and in particular, the review of planned savings through investment pooling.

The budget takes into account the investment strategy of the Fund, historic trends and results of the year ended 31st March 2018.

Variances for the six months to 30th September 2018 against the key budget headings are outlined as follows.

INCOME

Contributions from employers and employees
£43.2m adverse variance for 6 months to 30 September 2018

The budgeted contribution income from employers includes the recognition of the 2018/19 element of future service rate and deficit contributions received in advance from a number of Fund employers. After the budget was agreed, and on the basis of the opinion of the Fund's external auditors, Grant Thornton, an agreed adjustment was made to the statutory accounts of the Fund to recognise all advance contributions in the year of receipt. This results in a material favourable variance against budget for 2017/18 and an adverse variance of approximately £90m for the full year to 31 March 2019. Restating the budget for this amendment would result in a budget of approximately £163m for contribution income and a forecast favourable variance of £3.0m.

2019/20 contributions will be similarly affected but the 2019/20 budget will reflect the reduced level of income and no variance in respect of prepayments will be reported through the monitoring.

Transfers in to the Fund
£2.3m under recovery for 6 months to 30 September 2018

As was reported to the Committee in September there is no apparent historic trend in respect of value or timing of transfers in to the Fund. The year to date favourable variance has been carried forward to 31 March 2019 and no further variance has been assumed for the second half of the year.

Investment income
£47.2m favourable variance for 6 months to 30 September 2018

Of the £47.2m favourable variance, £46.8m is attributable to pooled investments. The budget for income from pooled investments did not assume any % growth. Pooled investment income includes dividends received into the global equities pool which are reinvested and form part of the movement in market value on the net assets statement.

Smaller, favourable variances in income from fixed income investments (£2.8m), foreign exchange (£2.8m) and other investment income (£1.6m) more than mitigate for the year to date shortfall in property rental income (£6.8m). Income from property is being reviewed but the shortfall is understood to be the result of weaker than anticipated rental rates and demand, together with general market conditions - particularly in the retail space.

A full year positive variance of £23.6m is recognised against investment income. Since income from pooled investments is reinvested this will have a net nil impact on the overall fund value as the surplus income is offset by an increase in market value of pooled investments.

EXPENDITURE

Transactions with members
£7.0m under spend for 6 months to 30 September 2018

Pensions in payment are broadly in line with budget (£1.8m adverse variance) as are refunds of contributions (£0.1m favourable).

Lump sum benefits payable and transfers out are both underspent by £4.4m against the budget to 30 September. At the end of June the under-spend was greater. The reduction in the variance indicates that this is a result of timing of expenditure rather than a recurring budget saving.

As is the case with income from transfers in, it is difficult to forecast expenditure of this nature and the full year forecast assumes payments in the second half of the year will be in line with budget, This results in a £5.2m forecast underspend for the full year against transactions with members.

Administration expenses
£0.3m saving against budget for 6 months to 30 September 2018

Budget monitoring for the first quarter of the year reported a saving of £0.3m for the full year and this position is unchanged as at 30 September 2018.

Due to timing of invoices received from the Local Pension Partnership (LPP) in the prior year, the Fund accounts for the year ended 31 March 2018 included an over accrual of £0.3m in respect of administrative expenses billed by LPP. This offsets current year actual costs.

There is no indication at present of a variance against the budget for current year expenditure which is based on a cost per member. For this reason, the saving created by the over-accrual is assumed to carry through to 31 March 2019.

Investment management expenses
£1.6m underspend against budget for 6 months to 30 September 2018

An underspend of £1.0m on pooled investments, £0.2m on transition fees and £0.7m on commission and agents charges is offset by an unbudgeted cost of £1.9m withholding tax. Withholding tax is not budgeted as it is recoverable over time.

The £1.2m underspend on property expenses is in line with expectations as the majority of cost in the current year is on capital items which are included in the property value on the balance sheet rather than included within revenue expenditure. Spend for the second half of the year is assumed to be in line with budget.

£3.2m budget for property management fees has been realigned from oversight and governance to investment management during the second quarter of the year. There is a £0.4m saving in the first six months against this budget.

Investment management expenses are reported by underlying asset managers on an arrears basis, usually quarterly. For this reason it is necessary to estimate fees on a quarterly basis and adjust in subsequent months when data becomes available. The budget includes an expectation that fees will increase as a result of the transparency agenda.

Total costs previously absorbed within asset value have not yet been separately identified and will continue to be quantified over the year. This process may not be completed by the end of the year as all Funds move towards greater transparency of cost and investment reporting.

Oversight and governance expenses
£0.3m underspend against budget for 6 months to 30 September 2018

£0.2m underspend on other advisory fees can be attributed to the review of cost reporting through the year and the alignment of budgets for performance monitoring and professional fees.

The remaining £0.1m underspend on oversight and governance is due to phasing of invoices receivable from external advisors. No full year variance has been recognised as at 30 September 2018 in this budget category.

NET POSITION

Year to date
A favourable net variance of £10.9m against budget has been reported at the end of the first half of the year and comprises over-recovery of income of £1.7m and an under-spend against expenditure budgets of £9.2m. The reduced cash flow from employer contribution income as a result of earlier prepayments is offset by higher than expected investment income in the first six months of the year.

Full year
A net variance of £57.7m overspend is forecast for the year to 31 March 2019.

It is difficult to forecast investment income accurately and for this reason the second half of the year is assumed to be in line with budget.

The full year income to the Fund is forecast to be under budget by £65.1m due to the recognition of approximately £85.1m contributions income relating to the current year in 2017/18, an under-recovery of transfers in (£2.3m) and employee contributions (£1.3m)and the carry forward of 'surplus' investment income of £23.6m from the first half.

Full year expenditure is forecast to be underspent by £7.5m, with the most significant variances being against transactions with members (£5.2m), investment management expenses (£1.7m), administration costs (£0.3m) and oversight and governance costs (£0.3m).

Actual and budget results for the nine month period to 31 December 2018 will be analysed and a revised full year forecast will be presented to the Committee at the March meeting.

Consultations

Local Pensions Partnership consulted in respect of investment management fees.

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 will inform future budget setting and forecasting. The inclusion of a full year forecast should assist in providing an 'early warning' of potential overspends and may enable mitigating action to be taken in year.

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