Pension Fund Committee
Meeting to be held on Friday, 7 February 2020

Electoral Division affected: None;

Lancashire County Pension Fund Q2 Budget Monitoring 2019/20
Appendix 'A' refers

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Executive Summary

This report sets out the financial results of the Fund for the six months ending 30 September 2019 and compares them to the budget for the same period. An updated forecast for the full year to 31 March 2020 is also included.

Recommendation

The Committee is asked to review the financial performance of the fund for the six months to 30 September 2019 and make comments on the variances outlined in the report.

Background and Advice

A one year budget for the Fund was approved by the Pension Fund Committee on 29 March 2019.

The budget forecasts a net income for the year of £13.3m, available for investment, before accounting for changes in the market value of investments during the year. The budget incorporates a reduction in contribution income from employers as a result of the accounting treatment of amounts paid in advance.

Appendix 'A' sets out a favourable budget variance of £29.4m for income for the first 6 months of the financial year and a £2.9m favourable variance on expenditure for the same period.

An updated forecast for the year to 31 March 2020 has been included in the report at Appendix 'A'. The forecast sets out an estimated £33.8m underspend against budget for the year.

Individual variances against budget are explained in more detail below.

Income for 6 months ended 30 September 2019
Budget £185.2m, actual £214.6m – favourable variance of £29.4m

Income from investments generated a £21.1m surplus during the first half of the year, against a budget of £95.6m. The budgeted increase in net property rental income compared to last year has not yet been realised but this under-recovery is more than offset by a significant favourable variance on income from pooled investments.

Transfers in during the first half of the year amounted to £8.8m against a budget of £4.6m, a surplus of £4.2m. This is a further favourable variance, building on the budget surplus reported at the end of June 2019. The flow of funds into and out of the Fund in respect of transfers is difficult to forecast and may not be indicative of the full year.

Contribution income is also showing a budget surplus after the first six months of the year (£4.1m variance).

Income forecast for year to 31 March 2020

The full year income forecast has been updated to £403.5m against a budget of £370.5m, anticipating a favourable variance of £33m.

The main contributor to the forecast variance is investment income for which the half year variance of £21.1m has been assumed to carry forward to the end of the year. No additional budget variance for investment income has been recognised for the second half of the year as this is dependent on a number of variables.

The current level of contribution income has been assumed to continue for the remainder of the year, resulting in a full year forecast income of £177.9m, which is £7.7m higher than the original budget.

No additional budget variance has been assumed for income from transfers, with the second half of the year forecast at budget levels, resulting in a forecast variance of £4.2m in total for transfers in.

Expenditure for 6 months ended 30 September 2019
Budget £183.5m, actual £180.6m – favourable variance of £2.9m

There are 4 elements of the expenditure budget which have a budget variance of more than £1m for the 6 month period.

Pension benefits paid, including lump sum payments are currently showing an underspend against budget of £14.6m. This is under review but it is considered likely that this is a consequence of budget assumptions rather than a payment delay. An update will be provided at the next meeting.

There is a £4.2m adverse variance on transfers out – with the actual transfers out for the first 6 months being in excess of budget. This effectively writes off the budget surplus on transfer income although the two are not directly linked.
Property expenses for the first half of the year are £3.1m in excess of budget. The Fund's property manager has advised that the overspend is due to the timing of expenditure reporting around the transition from Knight Frank Property Management to BNP Paribas. Costs reported in the first 3 months of this year were incurred before 1 April 2019 but not identified and therefore not accrued in the prior year.

Investment management fees on pooled investments are £4.4m above budget. These fees are an estimate of costs embedded in market value of investments for the 6 month period. The budget reflects the charging of performance fees on an annual basis by certain managers, with the impact that the charges are slightly higher in the first and last quarters of the year, rather than being steady through the year. The fees are dependent on the market value of investments and the performance of the underlying assets and managers. The estimates are also impacted by the timeliness of the provision of information by sub-fund managers who generally report quarterly in arrears. The Fund is working closely with the Local Pensions Partnership to more accurately accrue for quarterly fees. This work is being done alongside work required to comply with the transparency and Markets in Financial Instruments Directive agendas.

Expenditure forecast for year to 31 March 2020

The full year expenditure forecast has been updated to £356.4m against a budget of £357.2m, anticipating a favourable variance of £0.8m.

Until the review of pension benefits paid is concluded the 6 month saving of £14.6m has been carried forward to 31 March 2020 but no additional underspend for the second half of the year has been recognised.

As for transfers in, transfers out have been forecast at budget for the second half of the year with a full year forecast overspend of £4.2m.

It is forecast the pooling of the national property portfolio will lead to a decrease in the value of directly invoiced investment management fees of approximately £1.5m, being the direct charges to the Fund of Knight Frank and BNP Paribas management fees. There will be a corresponding increase in the fees on pooled investments which overall are forecast at £8.9m above budget for the year, assuming the level of fees for the second half of the year is consistent with the first.

Minimal expenditure on the property portfolio is forecast for the second half of the year and a full year overspend of £1.6m on this budget has been forecast. The national property portfolio was transitioned to the LPPI Real Estate fund on 1 October 2019. Any future revenue expenditure on these assets will be a pool expense and the Fund will no longer record rental income from these assets but will instead recognise increased income from pooled investments. A small number of legacy assets were retained on the Fund's balance sheet, due to them being on the market for sale or located outside of the English tax regime, together with the county portfolio. Expenditure on these assets will continue to be reported separately by the Fund.

Net impact of full year forecast – favourable budget variance of £33.8m
Consultations

Local Pensions Partnership for investment and administrative expenses.

Implications:

This item has the following implications, as indicated:

Risk management

Regular budget monitoring is a key control for the Fund. It should assist in the financial management of the Fund and provide an indication of significant variances from expectations.

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