

## **Pension Fund Committee**

Meeting to be held on Friday, 12 March 2021

Electoral Division affected: None;
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## **Lancashire County Pension Fund 2021/22 Budget** (Appendix 'A' refers).

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### **Executive Summary**

A one-year budget has been set for the Lancashire County Pension Fund for the year ending 31 March 2022.

### **Recommendation**

The Committee is asked to approve the budget for the year ending 31<sup>st</sup> March 2022, as set out in Appendix 'A' to this report.

### **Background and Advice**

It is not a constitutional requirement for a pension fund to set an annual financial budget, but it is considered a useful monitoring tool for assessment of the overall financial position and performance.

This budget sets out a reduction in money available for investment (before accounting for changes in the market value of investments during the year) of £37.1m, an 18% variance from forecast results for the year ending 31<sup>st</sup> March 2021. The reasons for the variance and other key budget assumptions are outlined in more detail below.

The proposed budget for Lancashire County Pension Fund for the year ending 31<sup>st</sup> March 2022, is set out in Appendix 'A' to this report.

The following have been taken into account in setting the one-year budget:

- The latest forecast for the year ending 31<sup>st</sup> March 2021 which is also included in the agenda for this meeting.
- Information received from the Local Pensions Partnership and Knight Frank Investment Management in terms of investment income, administration and investment management expenditure.

- The 2019 actuarial valuation in respect of contribution income receivable,
- The current investment strategy.
- Contractual agreements in respect of oversight, governance and investment management fees.

Previous budget assumptions have also been reviewed and adjusted where appropriate.

Key assumptions supporting the budget are set out below

## **INCOME**

### **Income from members and employers**

Contribution income for the year ending 31<sup>st</sup> March 2022 excludes receipts from employers who chose to pay future service rate and/or deficit contributions in advance following the 2019 actuarial valuation.

Certain large employers within the Fund were offered the option to 'prepay' contributions for the 3 years ending 31<sup>st</sup> March 2023. The employers opting to take this opportunity benefited from a contribution rate discount and under accounting principles for revenue recognition, the income to the Fund was reported in the year of receipt. This accounting treatment was agreed with the Fund's external auditor, the rationale being that the Fund has the beneficial 'ownership' of the cash on receipt, with no contractual obligation to return it.

This accounting treatment results in reduced contribution income being reported for 2021/22 and 2022/23. The up-front payments were received in April and May 2020 and these cash receipts are included in the overall value of the Fund either through recognition of investments purchased with the cash or as part of the Fund's cash balance.

The element of the prepayment which is attributable to the year ending 31<sup>st</sup> March 2022 is approximately £87m. The budgeted Fund Account attached as Appendix 'A' has been extended to reflect the net position had the contributions not been recorded on receipt. The result reports a net surplus of cash available for investment of £50m rather than the budget deficit of £37m and illustrates the impact that this accounting treatment has on the reported results of the Fund.

The public sector pay freeze has been applied to employee contributions and a 0% pay award has been assumed for other, non-public sector employers. As a result, employee contributions are budgeted to be equal to the forecast full year for 2020/21.

The income in respect of pension strain has also been held at the current year forecast amount as uncertainty around the exit cap continues and it is assumed that

this will impact on the number of members seeking early retirement or receiving pension enhancements.

## **Investment income**

Due to the continuing impact of the covid-19 pandemic and for prudence, no increase in investment income has been budgeted, with the exception of £8m additional income from pooled property investments.

The forecast for 2020/21 includes distributions from pooled property equivalent to net rental income for 9, rather than 12, months. The pooled investment properties were previously held as direct assets of the Fund and the policy was to recognise the rental income on an accruals basis, as it fell due. The income recognition policy for pooled investments is to record the income on receipt. For this reason, the distribution in early 2020/21 had been reported as rental income in 2019/20 and income following transition was not recognised until the second quarter of 2020/21. The budget for the year ending March 2022 reflects a full year of income from pooled properties.

## **EXPENDITURE**

### **Benefits payable**

Benefits payable have been budgeted to increase by RPI of 1.1%.

### **Transfers out and payments to leavers**

No increase to payments in respect of leavers has been included in the budget.

### **Pensions administration expenses**

The budget for administration fees payable to Local Pensions Partnership Administration Limited (LPPA) reflects the agreed increased cost per member for core administration services and incorporates the following:

1. The provision of the new website and it's new functionality i.e. webchat
2. The new telephony solution implemented during deployment of homeworking
3. The implementation of an e-signatory tool to enable more processes to be completed online
4. Regular tracing and a monthly mortality screening using Target Professional Services
5. A full year of the newly established LPPA Risk & Compliance Function
6. Targeted campaigns and training for Employers via the LPPA Engagement Team

The core fee excludes work not considered 'business as usual'. This includes anticipated 'data cleansing' work and charges arising due to the implications of McCloud. The Fund budget includes £108k as an estimate for these pieces of work which will be the subject of specific engagement fees.

The administration expense budget also includes an estimate for potential write-offs in respect of unpaid Fund invoices.

The transfer of employer risk services from Local Pensions Partnership Administration to Lancashire County Council is incorporated in the budget, the saving funding the additional costs set out above and the increased Lancashire County Council staff recharge included within oversight & governance costs.

### **Investment management expenses**

The budget for investment management expenses includes both invoiced fees and fees which are embedded in the net asset value of investments.

The majority of invoiced fees are payable to Local Pensions Partnership Investments Limited for the management of non-pooled investments. These invoices are calculated on the basis of the market value of those investments and the budget of £1m reflects the transition of the majority of the Fund's investments into pooled arrangements. The budget is consistent with the level of invoicing through the third quarter of 2020/21 with an asset growth assumption of 5% applied.

Other directly invoiced fees are payable to the Fund's property managers and other directly held investment managers. The forecast for the year ending 31<sup>st</sup> March 2021 includes a non-recurring performance fee relating to the Fund's 'Logistics North' investment.

Local Pensions Partnership Investments Limited do not invoice the Fund directly for the management of pooled investments but instead these fees are recovered through a deduction from the distributions paid to the Fund. The budget for these fees is £11.2m compared to the previous year budget of £9.4m. There are a number of reasons for the increase.

The cost of managing pooled rather than non-pooled funds is greater and due to the investment of cash (treated as a non-pooled investment) into pooled infrastructure and credit investments, together with further transition of legacy credit funds into pooled investment vehicles, the proportion of investments within pools has increased. Although the Local Pensions Partnership management cost for pooled investments is higher than for those remaining on the Fund balance sheet, the fees are lower than would be charged by external managers due to the economies of scale achieved through asset pooling.

The assumed 5% asset growth also results in an increase in the fee payable on pooled assets under management.

The fees embedded in the value of underlying investments within the pools have been budgeted at an amount equal to the forecast for the year ending 31<sup>st</sup> March 2021. As has been reported to Committee through quarterly budget monitoring reports, these fees are inherently difficult to forecast and are reported by managers in arrears. Performance of individual investments can result in significant fee increases or reductions which are not budgeted.

## **Oversight and governance expenses**

Performance management and the Local Pensions Board budgets reflect the annual inflationary increase in allowances paid to the Fund's independent investment advisors and the Chair of the Local Pensions Board.

The budget for advisory fees has been increased by £50k to provide for any additional internal audit work which may be commissioned during the year.

The actuarial fees budget has been increased to include £65k to cover the additional support which will be provided by the Fund's actuary in respect of employer risk services.

The fee for external audit is currently the subject of a nationwide consultation. An increased cost is expected due to the heightened scrutiny being placed on the audit of pension funds in general and in particular around the valuation of level 3 investments (those which are not traded or for which observable market data or comparable investments are not available). An additional £10k has been included in the budget but to date no indication of the likely fee increase has been provided.

The increase in the budgeted staff recharge from Lancashire County Council incorporates additional resource for employer risk and also reflects an updated structure within the team. The expected additional charge has not yet been agreed with Lancashire County Council and has been included in the Fund budget for prudence.

## **NET POSITION**

This budget sets out a reduction in money available for investment (before accounting for changes in the market value of investments during the year) of £37.1m.

This budgeted deficit is primarily due to the recognition of employer contributions paid in advance as income in 2020/21, in line with generally accepted accounting practice and as agreed with the Fund's external auditors Grant Thornton.

The short fall is compounded by an expectation of reduced investment income, relative to prior years, due to the ongoing impact on market conditions of the covid-19 pandemic which is not budgeted to be mitigated by reduced investment management expenditure.

## **Consultations**

The Local Pensions Partnership for pension administration and investment management expenses. Knight Frank Investment Management for investment management and property management expenses.

**Implications:**

This item has the following implications, as indicated:

**Risk management**

Regular monitoring against the budget will provide a useful tool for reviewing the financial position and performance of the Lancashire County Pension Fund, providing an analysis of significant variances from expectations.

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

Paper	Date	Contact/Tel
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N/A

Reason for inclusion in Part II, if appropriate

N/A