Pension Fund Committee
Meeting to be held on Friday, 11 March 2022

Electoral Division affected: N/A;

Lancashire County Pension Fund 2022/23 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 2023.

Recommendation

The Committee is asked to approve the budget for the year ending 31st March 2023, 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 £19.7m after taking into account prepayments made in 2020 in respect of the year ended 31st March 2023). The rationale behind the budget and key budget assumptions are outlined in more detail below.

The proposed budget for Lancashire County Pension Fund for the year ending 31st March 2023 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 31st March 2022 which is also included in the agenda for this meeting as well as actual experience for the year ending 31st December 2020 for some items.

- 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 31st March 2023 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 31st 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 31st March 2022 is approximately £80m. 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 an expenditure in excess of income of £20m rather than the budget deficit of £100m and illustrates the impact that this accounting treatment has on the reported results of the Fund.

The anticipated 20/21 pay award has been applied to employee contributions as well a 2% pay award for 21/22 which is in line with the figure used in LCC's Medium Term Financial Strategy, these figures have also been assumed for other, non-public sector employers. As a result, employee contributions are budgeted to be higher to the forecast full year for 2021/22.

The income in respect of pension strain and transfers in have been based on the average cost from January 2020 to December 2021.

Investment income

The budget for 22/23 has used the March 21/22 forecast, adjusting for a £18.5m one off income amount received in 21/22. This has then been increased in line with LPPI's long term growth assumption of 5%.

EXPENDITURE

Benefits payable

Benefits payable have been budgeted to increase by September CPI of 3.1%.

Transfers out and payments to leavers

Transfers out have been estimated using the same methodology as transfers in and pension strain using an average from January 2020 to December 2021.

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. an inflationary uplift of 4.0%;
2. the 1.25% employer Health & Social Care levy effective which becomes payable from April 2022;
3. the cost of additional temporary headcount recruited to provide operational resilience for the migration to UPM and reduction in systems costs as we transition away from the current system, Altair

The core fee excludes work not considered to be 'business as usual'. There is the potential for additional work to be required in the year, for example work on the McCloud issue therefore the Fund budget includes £100k to cover additional work. Any such work will be the subject of specific engagement fees.

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 (see item 'LPP directly invoiced investment management fees' on appendix A). These invoices are calculated on the basis of the market value of those non-pooled investments and the budget of £0.8m reflects that the majority of the Fund's investments are now held pooled arrangements. The budget is consistent with the level of invoicing through the third quarter of 2021/22 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 (see item ' DIRECTLY INVOICED non LPP investment management fees - direct holdings' in appendix A).

The most significant investment fee cost is 'Investment management fees on pooled investments' in appendix A. This comprises of management fees and performance fees.

Management fees: 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 £13.2m compared to the previous year budget of £11.2m. The increase is principally due to an assumed increase in the value of the Pools.

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

Also Included within this is the budget for fees embedded in the value of underlying investments within the pools. This has been calculated at an amount equal to the 2020/2021 fees for the management and transaction elements increased by 5% for assumed growth in 21/22 and for another 5% in 22/23.

Performance fees: The budget also makes a provision for embedded performance fees based on recent experience. As has been reported to Committee through quarterly budget monitoring reports, these fees are inherently difficult to forecast and many pension funds do not include this cost within their budgets. Therefore, there is likely to be significant variation from this budget during the year.

Although investment performance for 2022/23 is not expected to be as strong as it has been in prior years, performance fees are reported by managers in arrears and some fees related to strong performance in 2021/22 will crystalise in the 2022/23 budget. This has been taken into account in setting the budget to ensure that the budget is prudent.

Oversight and governance expenses

The Performance management budget has been based on the 21/22 forecast, adjusted to reflect the annual inflationary increase in allowances paid to the Fund's independent investment advisors as well as the conclusion of the Investment Service Based Review work.

The Local Pensions Board budget has remained in line with 21/22.

The budget for advisory fees has been decreased due to actuals being less than anticipated in 21/22.

The actuarial fees budget has been increased to reflect increased actuarial work relating to the 2022 Actuarial Valuation.

The fee for external audit is currently uncertain but given the increased scrutiny on public sector accounts, we have added a modest increase on the 21/22 budget.

The increase in the budgeted staff recharge from Lancashire County Council incorporates additional resource required for the pensions team, as well as reviewed resourcing for the finance team.

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 £99.8m.

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

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
N/A		

Reason for inclusion in Part II, if appropriate

N/A