Pension Fund Committee
Meeting to be held on Friday, 10 March 2023

Electoral Division affected: N/A;

Lancashire County Pension Fund 2023/24 Budget
(Appendix 'A' refers)

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Brief Summary

A one-year budget has been set for the Lancashire County Pension Fund for the year ending 31st March 2024.

Recommendation

The Committee is asked to approve the budget for the year ending 31st March 2024, as set out in Appendix 'A' to this report.

Detail

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 an increase in money available for investment (before accounting for changes in the market value of investments during the year) of £139.2m. 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 2024, 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 2023 which is also included in the agenda for this meeting as well as actual experience for the financial years ending 31st March 2021 and 31st March 2022 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 2022 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 2024 is based on estimated figures provided to the Fund by the actuary, Mercer, including revised employer contribution rates (following the 2022) valuation which are to be implemented from 1st April 2023. The figure also includes expected receipts from employers who chose to pay future service rate and/or deficit contributions in advance following the 2022 actuarial valuation (i.e. prepayments).

Certain large employers within the Fund were offered the option to 'prepay' contributions for the 3 years ending 31st March 2026. 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 will 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 will result in increased contribution income being reported for 2023/24. The up-front payments are due to be received in April 2023 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.

Based upon the latest information available regarding which employers will take up the prepayment option, the element of the prepayment which is attributable to the year ending 31st March 2025 and 31st March 2026 is approximately £119.4m. This budget is based on an assumption that LCC will make a prepayment of pension contributions for the 3-year period. This has yet to be formally communicated to the Pension Fund, but discussions so far indicate that the prepayment will most likely be made.

The budgeted Fund Account attached as Appendix 'A' has been extended to reflect the net position had the contributions not been recorded on receipt. This is provided for information only at the end of the appendix. The result reports a net surplus of cash available for investment of £19.8m rather than the budget surplus of £119.4m and illustrates the impact that this accounting treatment has on the reported results of the Fund.

The estimated 23/24 pay award has been applied to employee contributions at 5% 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 than the forecast full year for 2022/23.

Deficit recovery contributions are lower than in prior years due to the improved funding position resulting in fewer employers being in a deficit.

The income in respect of pension strain and transfers in have been based on the average cost from January 2020 to November 2022.

Investment income

The budget for 23/24 has used the March 22/23 forecast, adjusting 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 10.1%.

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 November 2022.

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. Regulatory changes for estimated costs of McCloud and Pensions Dashboard account for 5.7% of recoverable costs;
2. the cost of additional temporary headcount recruited to provide operational resilience for the migration to UPM was assumed to drop out in 22/23 will continue into 23/24
3. Inflation is significantly higher than anticipated.

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 and the creation of the pensions dashboard therefore the Fund budget includes £120k 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. These invoices are calculated based on the market value of those non-pooled investments and the budget of £0.5m reflects that the majority of the Fund's investments are now held in pooled arrangements. The budget is consistent with the level of invoicing through the third quarter of 2022/23 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 directly invoice the Fund for the management of pooled investments but instead these fees are recovered through a deduction from the distributions paid to the Fund.

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 2021/2022 fees for the management and transaction elements increased by 5% for assumed growth in 22/23 and for another 5% in 23/24.

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.

Investment performance for 2022/23 has not been as strong as it has been in prior years therefore as performance fees are reported by managers in arrears some fees related to performance in 2022/23 will crystalise in the 2023/24 budget. Bearing in mind the long-term growth expectation from LPPI of 5%, performance fees are anticipated to be somewhere between 2021/22 and what has been seen in 2022/23 so far. These factors have been considered in setting the budget to ensure that it is prudent.

The property expenses have been increased for an adjustment in the accounting treatment, this has grossed up the property income and expenditure by approximately £1m each. Increased costs due to more vacant units in the properties are also anticipated and there were some additional costs in 22/23 that are not considered to be recurring.

Oversight and governance expenses

The Performance management budget has been based on the 22/23 forecast, adjusted to reflect the annual inflationary increase in allowances paid to the Fund's independent investment advisors.

The Local Pensions Board budget has been increased slightly on 22/23 due to the anticipated appointment of a new chair 100% payable by the Fund from October 2022.

The actuarial fees budget has been decreased to reflect decreased actuarial work after the completion of the 2022 Actuarial Valuation.

The fee for external audit is currently uncertain but given the increased scrutiny on public sector accounts, a modest increase on the 22/23 budget has been included.

The increase in the budgeted staff recharge from Lancashire County Council reflects assumed salary increase of 5%.

NET POSITION

This budget sets out an increase in money available for investment (before accounting for changes in the market value of investments during the year) of £139.2m.

This budgeted surplus is primarily due to some large employers opting to take up the option to prepay the full 3-year employer contributions in line with generally accepted accounting practice and as agreed with the Fund's external auditors Grant Thornton.

Consultations

Local Pensions Partnership Administration Limited
Local Pensions Partnership Investment Limited
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