Pension Fund Committee
Meeting to be held on Friday, 8 March 2024

Electoral Division affected:
N/A;

Lancashire County Pension Fund Budget 2024/25
(Appendix 'A' refers)

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Brief Summary

A one-year budget has been set for the Lancashire County Pension Fund (LCPF) for the year ending 31st March 2025.

Recommendation

The Committee is asked to approve the budget for the year ending 31st March 2025, 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 a surplus of £9.3m once the impact of prepayments has been smoothed. Without smoothing there is a deficit of £52.0m. Further information on prepayments is below.

It is important to consider the budget in the context of wider investment returns. The budget is set before taking into consideration the changes in the market value of investments during the year. For context in the 9 months to 31st December 2023 the Fund is showing a Surplus of £147m, however, the value of the Fund has increased from £10.8bn to £11.4bn. Therefore, the Fund has an additional c£420m available to cover liabilities due to an increase in investment values over and above the surplus shown in the budget monitoring report.

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 2025, 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 2024 which is also included in the agenda for this meeting as well as actual experience for the financial years ending 31st March 2022 and 31st March 2023 for some items.

- Information received from the Local Pensions Partnership and Knight Frank Investment Management in terms of investment income, administration expenses, 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 2025 within the budget is based on actual contributions submitted to the Fund by the employers to 31st January 2024, this has been adjusted for an estimated pay award.

There is an option for employers to 'prepay' contributions and this impacts on the level of future service rate contributions over time. Certain large employers within the Fund opted to prepay contributions in 2023/24 for the 3-year period ending 31st March 2026. 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 will result in decreased contribution income being reported for 2024/25 compared to 2023/24.

The element of the prepayment which is attributable to the year ending 31st March 2025 is approximately £61.3m. The budgeted Fund Account attached as Appendix 'A' has been extended to reflect the net position had the contributions been recognised in 2024/25 and 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 £9.3m rather than the budget deficit of £52.0m and illustrates the impact that this accounting treatment has on the reported results of the Fund.

The estimated 2024/25 pay award has been applied to employer and employee contributions at 3% 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 that participate in the Pension Fund. As a result, employee contributions are budgeted to be higher than the forecast full year for 2023/24.

Deficit recovery contributions are in line with 2023/24, however, terminating employers can cause large fluctuations to this figure due to a surplus/deficit payment by or to the Pension Fund on termination.

The income in respect of pension strain and transfers in have been based on the average cost from April 2021 to December 2023.

Investment income

The budget for 2024/25 is based on actual experience for 2022/23 and period ended 31st December 2023 with an assumed adjusted 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 6.7%.

Pensions paid has also been increased due to a 3.4% increase in pensioner numbers between 31st March 2023 – 31st December 2023.

Lump sum payments in 2023/24 are forecasted higher than anticipated, we believe some of the variance is due to the disruption to member service after the implementation of the new pensions administration system. As the service levels return to normal, we expect to see the lump sum payments return to expected levels.

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 April 2021 to December 2023.

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. Increase in demand due to regulatory changes, employer engagement and increased membership size.

2. McCloud and Pensions Dashboard implementation projects alongside their subsequent increased data requirements.
3. Additional resilience and client management capacity.

Further information on this is available in another agenda item.

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 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 does 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.

An assumption has been made of 5% asset growth which 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 the average of the 2021/2022 & 2022/23 fees for the management and transaction elements increased by 5% for assumed growth in 2023/24 and for another 5% in 2024/25.

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 2023/24 has not been relatively strong, most of this can be attributed to the Global Equity portfolio which does not incur performance fees.

Performance fees are reported by managers in arrears and some fees related to performance in 2023/24 will crystalise in the 2024/25 budget. Bearing in mind, the long-term growth expectation from LPPI of 5% we anticipate the performance fees to be somewhere between 2021/22 and 2022/23. Actual experience in these years has been considered in setting the budget to ensure that the budget is prudent.

The property expenses have been set using a forecast from the Fund's property managers Knight Frank.

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 £0.4m 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 2023/24 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 Investment management fees on non-pooled investments managed by 3rd parties in appendix A).

Oversight and governance expenses

The Performance management budget has been based on the 2023/24 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 assumed to be in line with 2023/24.

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 yet to be confirmed but given the increased scrutiny on public sector accounts, we have added a modest increase on the 2023/24 budget.

The increase in the budgeted staff recharge from Lancashire County Council reflects assumed salary increase of 3% and required resourcing within the Pensions Team structure.

NET POSITION

This budget sets out a decrease in money available for investment (before accounting for changes in the market value of investments during the year) of £52.0m. However, once prepayments have been smoothed, there is a surplus available for investment.

Appendix

Appendix 'A' is attached to this report. For clarification they are summarised below and referenced at relevant points within this report.

Appendix	Title
Appendix 'A'	LCPF Budget 2024-25

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