



Pensions Committee

27 March 2019

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| Report title | Budget 2019/20 and Financial Plan to 2023/24 | |
| Originating service | Pension Services | |
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Recommendation(s) for action or decision:

The Committee is recommended to approve:

- a. The Operating Budget for 2019/20;
- b. The Medium-Term financial plan for the period to 2023/24.

1.0 Purpose

- 1.1 The purpose of this report is to seek the Committee's approval of the Operating Budget for 2019/20 and the Medium-Term financial plan for the five years up to and including 2023/24.

2.0 Background

- 2.1 The operating budget for 2019/20 has been developed to reflect the objectives and priorities set out in the Fund's Service Plan, the impact of the continuing transfer of investment assets and responsibilities to LGPS Central Limited, agreed restructure proposals and action to mitigate risks highlighted in the risk register. All existing budgets have been subject to thorough review for on-going relevance and adequacy and adjusted where appropriate.
- 2.2 LGPS regulations allow for the costs of administering the Funds to be charged to the Funds themselves and not directly to employers. The actuary makes provision in the Actuarial Valuation for such costs.
- 2.3 The budget and forecast figures quoted in this report whilst expressed in terms of cost per scheme member it is recognised that this is often a blunt but widely used measure of pension schemes cost-effectiveness.
- 2.4 Regular monitoring of the budget, including the preparation of a forecast outturn, will be undertaken throughout the year and reported to Pensions Committee at quarterly intervals.

3.0 Operating Budget 2019/20

- 3.1 The recommended Operating Budget for 2019/20 is £81.8 million. It should be noted that this budget includes the full value of investment management costs i.e. in addition to invoiced management fees, estimates have been made for fees being deducted at source by external managers.
- 3.2 Of the total budget of £81.8 million, £81 million will be charged to West Midlands Pension Fund and £750,000 charged to the ITA Fund. However, recognising that the ITA Fund is making significant changes to investment strategy, it is likely that the costs to this Fund will see increases in future years, although at this stage this is not built into forecasts.
- 3.3 Table 1 sets out the proposed budget analysed by expenditure type with comparison to the 2018/19 budget.

Table 1 – Operating Budget 2019/20

| | 2018/19 Budget £'000 | 2019/20 Budget £'000 | Net growth/ (saving) Budget £'000 |
|--------------------------------------|-------------------------------------|-------------------------------------|--|
| Employees | 5,527 | 7,358 | 1,831 |
| Premises | 221 | 302 | 81 |
| Transport | 65 | 37 | (28) |
| Other Supplies and Services | 412 | 430 | 18 |
| Service Development | 765 | 949 | 184 |
| Professional Fees | 1,171 | 1,483 | 312 |
| Communications and Computing | 534 | 585 | 51 |
| Support Services | 544 | 634 | 90 |
| Miscellaneous Income | (180) | (584) | (404) |
| Net Expenditure | 9,059 | 11,195 | 2,136 |
| External Investment Management Costs | 65,201 | 65,936 | 735 |
| LGPS Central Charges | 4,425 | 4,669 | 244 |
| Total | 78,685 | 81,800 | 3,115 |
| | | - | |
| Funded by: | | - | |
| West Midlands Pension Fund | 77,935 | 81,050 | 3,515 |
| West Midlands ITA Pension Fund | 750 | 750 | - |
| Net Budget | 78,685 | 81,800 | 3,115 |

3.4 The main reasons for the net increase in the operating budget are:

- a) Increased staffing structure reflecting growing employer base, additional complexity of administering the Fund and new reporting requirements and ensuring that the Fund is in a position to deliver a high-quality service to scheme members, employers and broader stakeholders. This combined with a higher level of retained investment functions than had been anticipated at the outset of pooling along with ensuring proper oversight and governance of the pooling arrangements in accordance with government guidance. A fundamental review of staffing requirements to meet growing demands and building resilience means this element of the budget for staffing will see an increase of £1.8m (including an allowance for national pay awards) and has been foreshadowed at previous Committee meetings. This includes an estimate for interim resource for project work for 2019/20 and is not carried forward to future years, representing around 15% of the additional cost in the staffing budget.
- b) A net increase in professional fees for 2019/20 (£312,000) largely reflecting the triennial valuation year i.e. actuarial costs, along with additional risk and investment work associated with the valuation process.
- c) Higher costs relating to a mix of service development, service recharges and other ancillary costs reflecting some deferred spending from the 2018/19

financial year as well as a requirement to develop systems to meet both growing demand on the Fund's resources and enhance capabilities.

- d) Investment management costs can be difficult to forecast with a high level of accuracy given dependency on the underlying value of assets under management and also changes to asset allocation e.g. moving to more expensive asset classes for risk management and investment return purposes. At this stage Increased investment management fees resulting from assumed growth in assets under management of (£735,000). Following approval by Shareholders of LGPS Central Ltd budget an increase in the Fund's share of the Company's operational budget. It should be noted that the forecast does not include allowances for potential fee reductions which are expected to arise from investment pooling, but likewise does not include in changes to asset allocation which could see a move to more expensive asset classes for diversification and risk management purposes.

- 3.5 The Fund's staffing establishment stands at 140 permanent full-time-equivalent employees, including the Fund's graduate and industrial placement programme.

4.0 Medium Term Financial Plan

- 4.1 Table 2 sets out the Fund's forecast operating budgets for the next five years. These generally assume a continuation of existing activities, plus service development initiatives, adjusted for inflation, pay awards and other anticipated changes.

Tables 3 and 4 show the forecast cost of administration, oversight and governance per member and the cost of investment management as a percentage of net assets which are key measures of the Funds' cost efficiency over the medium term.

- 4.2 The forecasts reflect assumed growth of 6% per year in the value of the Funds' investment assets (inclusive of income), which links through to growth in investment management costs, being based largely on assets under management.
- 4.3 It is important to note that these operating budget forecasts assume that the Fund will continue to have growth in investments and costs as associated with the current structure throughout the medium-term, although it should be recognised that whilst savings in fees are expected to flow through from the roll out of LGPS Central Ltd as the Fund transitions assets, some of this may be offset by wider asset allocation changes. The forecasts for the later years can be considered as an indication of the level of costs based on the current service model, including the latest estimate of the cost of pooling. Further savings to reduce costs will be required to offset the costs of pooling. Any benefits from pooling are not anticipated within the period of this MTFP.

- 4.4 Tables 5 and 6 provide forecasts for all Fund activities from 2019/20 to 2023/24. There are some important caveats concerning these forecasts which are discussed at paragraph 4.6.

Table 2 – Forecast Operating Budgets 2018/19 to 2023/24

| | 2018/19 Budget £'000 | 2019/20 Budget £'000 | 2020/21 Forecast £'000 | 2021/22 Forecast £'000 | 2022/23 Forecast £'000 | 2023/24 Forecast £'000 |
|--------------------------------------|-------------------------------------|-------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
| Employees | 5,527 | 7,358 | 7,230 | 7,375 | 7,523 | 7,673 |
| Premises | 221 | 302 | 308 | 314 | 320 | 326 |
| Transport | 65 | 37 | 38 | 39 | 40 | 41 |
| Other Supplies and Services | 412 | 430 | 439 | 448 | 457 | 466 |
| Service Development | 765 | 949 | 450 | 450 | 450 | 450 |
| Professional Fees | 1,171 | 1,483 | 1,363 | 1,390 | 1,418 | 1,446 |
| Communications and Computing | 534 | 585 | 597 | 609 | 621 | 633 |
| Support Services (CWC recharges) | 544 | 634 | 647 | 660 | 673 | 686 |
| Miscellaneous Income | (180) | (584) | (595) | (607) | (619) | (631) |
| Net Expenditure | 9,059 | 11,195 | 10,477 | 10,678 | 10,883 | 11,090 |
| External Investment Management Costs | 65,201 | 65,936 | 69,892 | 74,086 | 78,531 | 83,243 |
| LGPS Central Charges | 4,425 | 4,669 | 4,949 | 5,246 | 5,561 | 5,895 |
| Total | 78,685 | 81,800 | 85,318 | 90,010 | 94,975 | 100,228 |
| | | | | | | |
| Funded by: | | | | | | |
| West Midlands Pension Fund | 77,935 | 81,050 | 84,568 | 89,260 | 94,225 | 99,478 |
| West Midlands ITA Pension Fund | 750 | 750 | 750 | 750 | 750 | 750 |
| Net Budget | 78,685 | 81,800 | 85,318 | 90,010 | 94,975 | 100,228 |

Table 3 – Cost per Scheme Member and Investment Costs as a Percentage of Net Assets (WMPF)

| | 2018/19 Budget £000 | 2019/20 Budget £000 | 2020/21 Forecast £000 | 2021/22 Forecast £000 | 2022/23 Forecast £000 | 2023/24 Forecast £000 |
|---|------------------------------------|------------------------------------|----------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| | | | | | | |
| Number of Members | 313,399 | 329,746 | 338,649 | 347,454 | 356,835 | 366,470 |
| | | | | | | |
| Total Administration, Oversight and Governance Costs (£000) | 8,071 | 10,445 | 9,727 | 9,928 | 10,133 | 10,340 |
| | | | | | | |
| Total Administration, Oversight and Governance cost per Member (£) | 25.75 | 31.67 | 28.72 | 28.57 | 28.40 | 28.22 |
| | | | | | | |
| Total Investment Management Costs (£000) | 69,626 | 70,605 | 74,842 | 79,332 | 84,092 | 89,138 |
| Investment Management Cost per Member (£) | 222.16 | 214.12 | 221.00 | 228.32 | 235.66 | 243.23 |
| Investment Management Costs as a Percentage of Forecast Net Assets | 0.44% | 0.47% | 0.47% | 0.47% | 0.47% | 0.47% |

Table 4 – Cost per Scheme Member and Investment Costs as a Percentage of Net Assets (WMITAPF)

| | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/24 |
|--|----------------|----------------|-----------------|-----------------|-----------------|-----------------|
| | Budget | Budget | Forecast | Forecast | Forecast | Forecast |
| Total Administration, Oversight and Governance Costs (£000) | 120 | 120 | 120 | 120 | 120 | 120 |
| Cost of Administration, Oversight and Governance per Member (£) | 23.58 | 23.58 | 23.58 | 23.58 | 23.58 | 23.58 |
| | | | | | | |
| Total Investment Management Costs (£000) | 630 | 630 | 630 | 630 | 630 | 630 |
| As Percentage of Total Net Assets | 0.13% | 0.12% | 0.12% | 0.12% | 0.12% | 0.12% |

Table 5 – Medium Term Forecasts (WMPF)

| | 2017/18 Forecast £m | 2018/19 Forecast £m | 2019/20 Forecast £m | 2020/21 Forecast £m | 2021/22 Forecast £m | 2022/23 Forecast £m | 2023/24 Forecast £m |
|--|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Contributions Receivable** | (1,089) | (335) | (350) | (660) | (674) | (694) | (715) |
| Other Income | (16) | (16) | (16) | (17) | (17) | (17) | (17) |
| Benefits Payable | 555 | 582 | 610 | 639 | 669 | 698 | 728 |
| Other Payments | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net Cost of Pensions | (549) | 232 | 244 | (37) | (22) | (13) | (4) |
| | | | | | | | |
| Investment Income | (198) | (211) | (219) | (230) | (242) | (257) | (272) |
| (Gains)/Losses in Value of Investments* | (651) | (693) | (720) | (754) | (796) | (844) | (895) |
| Return on Investments | (849) | (904) | (939) | (984) | (1,039) | (1,101) | (1,167) |
| | | | | | | | |
| Management Expenses | 79 | 78 | 82 | 85 | 90 | 95 | 100 |
| | | | | | | | |
| Net (Increase)/Decrease in the Fund | (1,319) | (594) | (613) | (934) | (969) | (1,019) | (1,071) |
| | | | | | | | |
| Opening Fund Balance | 13,909 | 15,420 | 16,015 | 16,628 | 17,565 | 18,535 | 19,554 |
| Closing Fund Balance | 15,227 | 16,015 | 16,628 | 17,565 | 18,535 | 19,554 | 20,625 |

* Note: for 2018/19 to 2022/23, investment assets are forecast to grow by 6% per year.

** Note: the contributions receivable figures for 2018/19 to 2019/20 reflect agreements with some individual employers to pay contributions in advance in 2017/18. Contributions 2020/21 reflect estimate of annual contributions post the 2019 actuarial valuation

Table 6 – Medium Term Forecasts (WMITAPF)

| | 2017/18 Forecast £m | 2018/19 Forecast £m | 2019/20 Forecast £m | 2020/21 Forecast £m | 2021/22 Forecast £m | 2022/23 Forecast £m | 2023/24 Forecast £m |
|--|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Contributions Receivable | (12) | (12) | (12) | (12) | (12) | (12) | (12) |
| Other Income | (3) | (3) | (3) | (3) | (3) | (3) | (3) |
| Benefits Payable | 30 | 31 | 32 | 33 | 34 | 35 | 36 |
| Net Cost of Pensions | 15 | 16 | 17 | 18 | 19 | 20 | 20 |
| | | | | | | | |
| Investment Income | (19) | (19) | (20) | (20) | (21) | (21) | (22) |
| (Gains)/Losses in Value of Investments* | (11) | (11) | (11) | (12) | (12) | (12) | (13) |
| Return on Investments | (30) | (30) | (31) | (32) | (33) | (34) | (34) |
| | | | | | | | |
| Management Expenses | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | | | | | | | |
| Net (Increase)/Decrease in the Fund | (14) | (14) | (14) | (14) | (13) | (13) | (13) |
| | | | | | | | |
| Opening Fund Balance | 491 | 492 | 505 | 518 | 531 | 544 | 556 |
| Closing Fund Balance | 504 | 505 | 518 | 531 | 544 | 556 | 569 |

* Note: for 2018/19 to 2022/23, investment assets are forecast to grow by 6% per year, however recognising the increasing maturity of this Fund and negative cashflow position, the forecasting will be subject to review as part of the actuarial valuation.

4.5 Table 7 provides the key assumptions used in preparing the medium-term forecasts.

Table 7 – Key Assumptions

| | 18/19 | 19/20 | 20/21 | 21/22 | 22/23 | 23/24 |
|--|--------------|--------------|--------------|--------------|--------------|--------------|
| Pay Award | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% |
| Consumer Price Inflation (December of preceding year) | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% |
| Increase in Total Number of Members * | 2.80% | 2.70% | 2.70% | 2.70% | 2.70% | 2.70% |
| Gross Growth in Investment Assets | 6.00% | 6.00% | 6.00% | 6.00% | 6.00% | 6.00% |

* Note: this projection is based on changes in membership numbers over the last five years.

4.6 The medium-term forecasts shown in Tables 5 and 6, are subject to change, in particular because:

- a) Contributions for 2020/21 to 2021/22 will be influenced by the 2019 actuarial valuation, and could be significantly different from the figures shown here;
- b) The local government sector has experienced, and will continue to experience for the foreseeable future, a combination of cost pressures and funding reductions, and it is not yet possible to quantify the extent to which this will translate into a long-term reduction in the number of active scheme members;
- c) Investment income and growth in asset value are very difficult to forecast and are likely to demonstrate much greater year-on-year volatility than shown here.
- d) The impact of the transfer of funds to the LGPS Central, both in terms of growth and costs

5.0 Financial implications

5.1 The financial implications are discussed in the body of the report.

6.0 Legal implications

6.1 This report has no legal implications.

7.0 Equalities implications

7.1 This report has no equalities implications.

8.0 Environmental implications

8.1 This report has no environmental implications.

9.0 Human resources implications

9.1 The report has no human resources implications.

10.0 Corporate landlord implications

10.1 This report has no corporate landlord implications.

11.0 Schedule of appendices

11.1 None

12.0 Schedule of background papers

12.1 Service Plan 2018-2024, Report to Pensions Committee, 27 March 2019