

Pensions Committee

30 March 2022

Report title	Budget 2022/23 and Financial Plan to 2026/27	
Originating service	Pension Services	
Accountable employees	Femi Olatunde	Interim Head of Finance
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Recommendations for decision:

The Pensions Committee is recommended to approve:

1. The Operating Budget for 2022/23.
2. The Medium-Term financial plan for the period to 2026/27.

1.0 Purpose

- 1.1 The purpose of this report is to outline to the Committee the proposed Fund Operating Budget for 2022/2023 and the Medium-Term financial plan for the five years up to and including 2026/2027, noting areas of development since 2021/2022.

2.0 Background

- 2.1 The operating budget for 2022/23 has been developed to reflect the objectives and priorities set out in the Fund's Corporate Plan, produced in response to growing service demand, changing regulatory requirements and governance standards, together with the Fund's own ongoing service transformation. All budgets have been subject to thorough review in context of the emerging programme of work required by the Fund, tested for adequacy and adjusted where appropriate.
- 2.2 LGPS regulations allow for the costs of administering the Pension Fund to be charged to the Pension Fund; costs do not flow directly to the Administering Authority or any other participating employers. The actuary makes provision in the triennial Actuarial Valuation for Fund administration and governance costs, with investment return targets and monitoring established net of investment management costs.
- 2.3 The budget and forecast figures quoted in this report are also expressed in terms of cost per scheme member, a widely used, though often a blunt measure of pension schemes costs. These indicators vary year-on-year and will increase over time as the Pension Fund matures, as a result of slowing membership growth and changing investment strategy.
- 2.4 Regular monitoring of the operating budget, including the preparation of a forecast outturn, will be undertaken throughout the year, and reported to Pensions Committee at quarterly intervals. Investment management costs are assessed and reported in detail on an annual basis, as the Fund collates and reviews Cost Transparency templates incoming from investment managers.

3.0 Operating Budget 2022/23

- 3.1 The recommended Operating Budget for 2022/23 is £116 million. This includes Net Expenditure of £15.7 million, with the balance relating to estimated total investment management costs. Investment management costs are reported and included on a fully transparent basis (i.e. in addition to invoiced management fees, estimates have been made for fees being deducted at source by external managers).
- 3.2 Table 1 sets out the proposed budget analysed by expenditure type with comparison to the 2021/22 budget.

Table 1 – Operating Budget 2022/23

	2021/22	2022/23	Net growth / (saving)
	Budget	Budget	Budget
	£'000	£'000	£'000
Employees	9,700	10,425	725
Premises	700	698	(2)
Transport	40	25	(15)
Other Supplies and Services	488	411	(77)
Service Development	1,054	1,412	358
Professional Fees	1,499	1,764	265
Communications and Computing	627	780	153
Support Services	733	774	41
Miscellaneous Income	(590)	(600)	(10)
Net Expenditure	14,251	15,689	1,438
External Investment Management Costs	82,539	95,397	12,858
LGPS Central Charges	5,225	4,768	(457)
Total	102,015	115,854	13,839

3.3 The main drivers for the increase in the Net Expenditure are:

3.3.1 Employees

The Fund's employee base continues to evolve and grow, as service areas are regularly reviewing resourcing requirements in response to service demand, capacity and the changing volume and skills sets required to support Scheme change and Fund service and operational development. The budget reflects an increase in resource to most service areas of the Fund, with capacity for front-facing services, benefit operations and to support our people and change initiatives.

Resources are being targeted at areas where the Fund has struggled to meet processing KPI and in anticipation of rising member contact as we see an increasing trend of interest in pension saving with the aim of increasing accessibility and support to members through our new office space and online services. Allowance has been made for a number of temporary roles to support project and implementation work (for the McCloud remedy and Pension administration software change). We continue to support an increasing apprenticeship and graduate trainee programme and offer all employees the opportunity to develop their careers through our training programme.

Total Fund headcount stood at 202 employees as at 31 December 2021. Targeted recruitment continues across service areas to fill current vacancies. An

update on the developing Fund structure will be provided to the Committee in June 2023.

3.3.2 Service development

Service development represents an estimate of in-year costs to support targeted development activity. The budget for 2022/23 includes allowance for system development by the incoming Pension software provider, third party administration support to aid processing of high volumes of benefit operations, pending system development and recruitment and a programme of work to support the development and enhancement of finance and investment operations to increase efficiency and strengthened resilience in these areas.

All activity is subject to programme development and oversight, taking a proportionate and well managed approach to change to ensure initiatives deliver value for money to the Fund. Due to capacity and competing priorities, some of this work is carried forward from 2021/22.

3.3.3 Professional Fees

The budget for professional fees has been developed to reflect the scope of work the Fund will undertake in partnership with its advisers over 2022/23 (which includes triennial funding and investment strategy review work). Several providers have been reprocured over 2021/22 with work programmes agreed to incorporate an increasing range of analysis to support the Fund in responding to the breadth of considerations facing Funds within the LGPS. 2022/23 will see an increase in analysis to support and enhance risk management (to include climate-related risk in both covenant and investment activity), targeted strategy review work, scenario planning and cost-effective support to enhance operational resilience. In using our advisers efficiently and for targeted activities it enables the Fund to continually evolve through innovation and appropriate challenge, delivering value for money alongside the Fund's own resources.

3.3.4 Communications and computing

Following an extended and extensive programme of procurement for the Fund's Pensions Administration software provider, Equiniti (EQ Paymaster) were awarded the contract and as noted above, system development is in progress with the aim of transitioning provider from April 2023. To allow for the required development and ongoing programme of activity with the Fund's current provider (Civica), the Fund has entered into a short-term contract to ensure continuity of service over 2022/23. Due to the short-term nature of the contract the supplier has levied additional costs which are the main driver for the increase in budget required for 2022/23.

Longer term costs are projected to be lower, with enhanced functionality being developed with the new provider over 2022/23.

3.4 The operating budget includes estimates for external investment management costs and LGPS Central charges, which have been revised as follows:

- External investment costs have been estimated based on reported costs for the prior year. The annual investment cost collection exercise for 2020/21 led to an increase in reported costs, in part due to increasing visibility and reporting by Fund managers but mainly driven by an increase in asset values over the year – during 2020/21 the Fund's net assets increased by £3.6 billion (23%). As noted in quarterly monitoring papers, actual cost can be variable and will depend on manager reporting, investment performance, changing asset allocation together with movements in market conditions and asset values during the year.
- Recharges from the LGPS Central pool have been estimated following approval of the LGPS Central Limited 2022/23 budget in February 2022, and an estimated allocation between Partner Funds. During 2021/22 the mark-up on recharges of services to clients of the pool was reviewed and reduced and this is the primary driver for the reduction in charge estimated for 2022/23. Allowance has been made for projected product development and use of pool products and services, with actual costs and recharges monitored quarterly during the year.

4.0 Medium Term Financial Plan

- 4.1 Table 2 sets out the Fund's forecast operating budgets for the next five years. These assume a continuation of existing activities, plus service development initiatives, adjusted for assumed inflation, employee cost (general pay award) and growth in membership and asset values. It should be noted that these assume a continuation of temporary roles and service development allowed for in 2022/23, some of which is in train to aid the Fund in its response to Scheme-wide change. In practice, budget requirements will continue to be reviewed and presented to Committee for review and approval each year.
- 4.2 Table 3 shows the forecast cost of administration, oversight and governance per scheme member and the cost of investment management as a percentage of net assets which provide a measure of the Fund's potential cost development over the medium term. As noted above, these are relatively blunt measures, and the Fund continues to commission independent benchmarking of its administration and investment activities to better inform the value of services offered to members and employers and the effectiveness of implementation of investment strategy. The classification of costs for reporting purposes is in line with CIPFA guidance, with a broad definition applied for "administration" costs such that it includes the majority of the Fund's day-to-day operational costs including premises and service services for all Fund service areas.
- 4.3 The forecasts reflect assumed growth of 4.6% per year in the return on the Fund's investment assets (inclusive of income), with indicative projection of

investment management costs, where most are based on assets under management, projected based on expected longer term cost as a percentage of assets, taking into account the Fund's longer term asset allocation target.

- 4.4 It is important to note that these operating budget forecasts assume that the Fund will continue to see growth in membership and invested assets, with elements of administration and governance costs as well as future benefit payments linked to inflation which has increased substantially over the last year (with assumed rate of 5.4% vs 1% in 2021/22, based on published December 2021 CPI, for the purposes for these projections). No allowance has been made for changes in membership (including increase in members drawing pension), with a lower overall projected increase in membership than prior years, reflecting the lower level of increase observed in recent years. In practice, investment management costs will be materially impacted by changing market conditions, asset values and changing asset allocation over time.
- 4.5 Table 4 provides forecasts for all Fund activities from 2022/23 to 2026/27. The assumptions underlying these forecasts are outlined in Table 5.

These forecasts are for illustration only.

Table 2 – Forecast Operating Budgets 2022-20223 to 2026-2027

	2022- 2023 Budget £'000	2023- 2024 Forecast £'000	2024- 2025 Forecast £'000	2025- 2026 Forecast £'000	2026- 2027 Forecast £'000
Employees	10,425	10,608	10,793	10,982	11,175
Premises	698	736	775	817	861
Transport	25	27	28	30	31
Other Supplies and Services	411	433	457	481	507
Service Development	1,412	1,412	1,412	1,412	1,412
Professional Fees	1,764	1,859	1,959	2,065	2,176
Communications and Computing	780	823	867	914	963
Support Services	774	787	801	815	829
Miscellaneous Income	(600)	(632)	(667)	(703)	(740)
Net Expenditure	15,689	16,052	16,426	16,814	17,215
External Investment Management Costs	95,397	106,756	116,803	120,480	124,259
LGPS Central Charges*	4,768	5,025	5,297	5,583	5,884
Total	115,854	127,833	138,526	142,876	147,358

*LGPS Central charges assumed to increase in line with inflation

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

	2022/23 Budget	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast
Number of Members	334,953	339,977	345,077	350,253	355,507
Total Administration, Oversight and Governance Costs (£000)	15,429	16,052	16,426	16,814	17,215
Total Administration, Oversight and Governance cost per Member (£)	46.06	47.21	47.60	48.00	48.42
Total Investment Management Costs (£000)	100,425	111,782	122,099	126,063	130,144
Investment Management Cost per Member (£)	299.82	328.79	353.83	359.92	366.08
Investment Management Costs as a Percentage of Forecast Net Assets	0.48%	0.52%	0.55%	0.55%	0.55%

- Growth in the Fund's membership has reduced in recent years, with an observed rate of 6.2% p.a. over 2014-2019, reducing to 1.2% p.a. 2019-2022 to date. The membership projection assumes the lower level of increases continues over the medium term.
- Investment management costs as a percentage of forecast net assets are expected to increase to around 0.55% as a result of implementation of planned changes to the Fund's strategic asset allocation. The Fund's long term strategic asset allocation aims to balance cost and risk whilst ensuring the Fund is positioned to achieve the required return over the long term, to meets its obligations of benefits payments to members. The increase in £ cost is driven by a combination of changing asset allocation and increasing asset values over the projection period.
- The allocation of costs between administration, governance and oversight and investment management is in line with guidance published by CIPFA (accounting for local government pension scheme management expenses – 2016 edition). Investment costs include third party custody and Fund accounting costs.

Table 4 – Medium Term Forecasts (WMPF)

	2022/23	2023/24	2024/25	2025/26	2026/27
	Forecast	Forecast	Forecast	Forecast	Forecast
	£m	£m	£m	£m	£m
Contributions Receivable**	556	576	599	620	642
Other Income	17	17	17	17	17
Benefits Payable	(724)	(763)	(804)	(847)	(893)
Net Cost of Pensions	(151)	(170)	(188)	(210)	(235)
Return on Investments *	957	1,001	1,047	1,095	1,146
Management Expenses	(116)	(128)	(139)	(143)	(147)
Net Increase/ (Decrease) in the Fund	690	703	721	742	764
Opening Fund Balance	20,806	21,496	22,200	22,920	23,662
Closing Fund Balance	21,496	22,200	22,920	23,662	24,426

* Note: for 2022/23 to 2026/27, return on investments is forecast to grow by 4.6% per annum.

** Note: the contributions receivable figures for 2022/23 reflect agreements with some individual employers who have already paid those contributions in advance.

4.6 Table 5 provides the key assumptions used in preparing the medium-term forecasts.

Table 5 – Key Assumptions (annual growth)

	22/23	23/24	24/25	25/26	26/27
Employee costs (general pay award)*	1.75%	1.75%	1.75%	1.75%	1.75%
Consumer Price Inflation (December of preceding year)	5.40%	5.40%	5.40%	5.40%	5.40%
Increase in Total Number of Members	1.50%	1.50%	1.50%	1.50%	1.50%
Growth in Investment Assets	4.60%	4.60%	4.60%	4.60%	4.60%

*For the purpose of this projection this is set in line with the latest NJC award.

[Note for all tables- All totals are subject to rounding]

4.7 The medium-term forecasts shown in Table 4 are subject to change, because:

- a) Contributions for 2023/24 to 2025/26 will be influenced by the 2022 actuarial valuation and could be significantly different from the figures shown here.
- b) The local government employers (and many other employers in the Fund) have experienced and will continue to experience for the foreseeable future, significant changes in the way they operate including ongoing cost pressures and service restructuring and, as such, it is not possible to quantify the extent to which this will translate and change the Fund's total membership, including active memberships and members moving to deferred or retired status.
- c) Inflation-linked costs and benefits will be materially impacted by the changing outlook and long-term rate of inflation
- d) Investment income and growth in asset values (and in turn investment costs) are difficult to forecast and could reasonably be expected to exhibit much greater year-on-year volatility than shown here.

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 direct legal implications.

7.0 Equalities implications

7.1 This report has no direct equalities implications.

8.0 Other potential implications

8.1 There are no other potential implications.

9.0 Schedule of background papers

9.1 Corporate Plan 2022-2027, Report to Pensions Committee, 30 March 2022

10.0 Schedule of appendices

10.1 None.