

Pensions Committee

22 March 2023

Report title	Operating Budget (2023) and 5-year Financial Plan	
Originating service	Pension Services	
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Recommendations for decision:

The Pensions Committee is recommended to approve:

1. The Operating Budget for 2023/24.
2. The Medium-Term Financial Plan for the period to 2027/28.

1.0 Purpose

- 1.1 The purpose of this report is to outline to the Committee the proposed Fund Operating Budget for 2023/24 and the Medium-Term financial plan for the five years up to and including 2027/28, noting areas of development since 2022/23.

2.0 Background

- 2.1 The operating budget for 2022/23 has been developed in conjunction with the Fund's Corporate Plan to support the delivery and achievement of its objectives both in the short and long term. These include continuing to enhance the operational resilience of the Fund and its service delivery to members and employers, as well as responding to changing regulatory requirements and governance standards. All budgets have been subject to thorough review in context of the programme of work required by the Fund, tested for adequacy and adjusted where appropriate.
- 2.2 Local Government Pension Scheme (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 blunt measure of pension schemes costs. These indicators vary year-on-year and will increase over time as the Pension Fund matures, due to slowing membership growth, changing investment strategy and general inflationary price increases (including salaries). Annual benchmarking of costs and value for money is undertaken and will next be reported to the Committee in June 2023.
- 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 as part of the year end accounts and audit timetable. The monitoring and reporting on these costs will continue to be reviewed and evolved by the Fund.

3.0 Operating Budget 2022/23

- 3.1 The recommended Operating Budget for 2023/24 is £122.7 million. This includes Net Expenditure of £19.5 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). These costs are calculated on the basis of the value of assets held by the Fund.

- 3.2 Table 1 sets out the proposed budget analysed by expenditure type with comparison to the 2022/23 budget.

Table 1 – Operating Budget 2023/24

£000	2023/24 Budget	2022/23 Budget	Net growth / (saving)
Employees	12,824	10,426	2,398
Premises	757	698	59
Transport	27	25	2
Other Supplies and Services	770	411	359
Service Development	1,653	1,412	241
Professional Fees	1,754	1,764	(10)
Communications and Computing	924	780	144
Support Services	838	773	65
Miscellaneous Income	(659)	(600)	(59)
Net Expenditure	18,888	15,689	3,199
External Investment Management Costs	97,670	95,403	2,267
LGPS Central Charges	6,181	4,768	1,413
Total	122,739	115,860	6,879

- 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 budgeted Fund headcount for 2023/24 stands at 272 (256 FTE), reflecting an increase of 11 (10.2 FTE) from the 2022/23 budget. This reflects an increase in resource to most service areas of the Fund, with the additional capacity for front-facing services, benefit operations and to support enhancements to our investment resource and governance arrangements.

Additional resources are being put in place to support the transition to the new Pension Administration System, and to enhance the People Services provision within the Fund to support ongoing recruitment and retention activities. As part of this we continue to support an increasing apprenticeship and graduate trainee programme and offer all employees the opportunity to develop their careers through our training programmes.

Allowance has been made within the budget for a general increase in the local government pay scales. At this point in time the increase is aligned to the assumptions made by the wider City of Wolverhampton Council for budgetary purposes.

3.3.2 Service Development

Service development represents an estimate of in-year costs to support targeted development activity. The budget for 2023/24 includes one-off allowances for the transfer to the new Pension Administration System, including third party administration support to aid processing of benefit operations during the transition, and written hard copy communications to all members on this and wider Scheme changes as required by disclosure regulations.

Service development also continues the programme of work begun in 2022/23 to support the development and enhancement of finance and investment operations increasing efficiency and strengthening 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.

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 2023/24 following on from the triennial funding and investment strategy review work in 2022/23. 2023/24 will see an increase in analysis to support and enhance risk management (to include climate-related risk), targeted strategy implementation work, and cost-effective support to enhance operational resilience.

3.3.4 Other Supplies and Services

The increased expenditure classified as Other Supplies and Services reflects the improved identification of subscriptions and other operations services within the budget and the ongoing development of communications with members and employers. These costs will continue to be reviewed over the coming periods.

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 and the current value of Fund assets. The budget is driven by the value of the assets with actual costs reviewed via the annual monitoring process. 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 March 2023, and an estimated allocation between Partner Funds. This includes the costs of governance, operations and investment management of assets by the pool company, determined in accordance with the cost sharing model and covering the products and services envisaged for the following year, following a period of engagement with the pool company and Partner Funds. 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 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 cessation of temporary roles and pension administration system service development costs allowed for in 2023/24, in line with the one-off nature of the expenditure. 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 the Chartered Institute of Public Finance and Accountancy's (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 support services for all Fund service areas.
- 4.3 The forecasts reflect assumed growth of 4.3% 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.

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 2023/24 to 2027/28. The assumptions underlying these forecasts are outlined in Table 5.

These forecasts are for illustration only.

Table 2 – Forecast Operating Budgets 2023-2024 to 2027-2028

£000	2023/24 Budget	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
Employees	12,824	13,452	13,882	14,270	14,642
Premises	757	818	850	876	902
Transport	27	29	30	31	32
Other Supplies and Services	770	832	865	891	918
Service Development	1,653	549	571	588	605
Professional Fees	1,754	1,857	1,931	2,092	2,051
Communications and Computing	924	845	878	905	932
Support Services	838	905	941	969	999
Miscellaneous Income	(659)	(712)	(740)	(762)	(785)
Net Expenditure	18,888	18,573	19,209	19,859	20,295
External Investment Management Costs	97,670	101,870	106,250	110,819	115,584
LGPS Central Charges*	6,181	6,675	6,942	7,151	7,365
Total	122,739	127,118	132,401	137,829	143,245

*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

	2023/24 Budget	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
Number of Members	344,599	349,768	355,014	360,340	365,745
Total Administration, Oversight and Governance Costs (£000)	17,003	16,779	17,360	17,950	18,352
Total Administration, Oversight and Governance cost per Member (£)	49.34	47.97	48.90	49.81	50.18
Total Investment Management Costs (£000)	105,736	110,339	115,041	119,879	124,893
Investment Management Cost per Member (£)	306.84	315.56	324.15	332.78	341.56
Investment Management Costs as a Percentage of Forecast Net Assets	0.53%	0.54%	0.55%	0.56%	0.56%

- 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 0.56% as a result of implementation of ongoing changes to the Fund’s strategic asset allocation. This will be revisited over 2023/24 to incorporate outlook following approval of the 2023 Investment Strategy Statement. 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 meet 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 (West Midlands Pension Fund (WMPF))

£m	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast	2027/28 Forecast
Contributions Receivable**	686	627	646	738	673
Other Income	17	17	17	17	17
Benefits Payable	(790)	(854)	(887)	(914)	(942)
Net Cost of Pensions	(87)	(210)	(224)	(159)	(252)
Return on Investments *	828	855	877	890	926
Management Expenses	(122)	(127)	(132)	(138)	(143)
Net Increase/ (Decrease) in the Fund	619	518	521	603	531
Opening Fund Balance	19,267	19,886	20,404	20,925	21,528
Closing Fund Balance	19,886	20,404	20,925	21,528	22,059

* Note: for 2023/24 to 2027/28, return on investments is forecast to grow by 4.3% per annum.

** Note: the contributions receivable figures for 2023/24 reflect agreements with some individual employers who are expected to pay 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)

	2023/24	2024/25	2025/26	2026/27	2027/28
Employee costs (general pay award)*	5.00%	5.00%	3.00%	2.00%	2.00%
Consumer Price Inflation (December of preceding year)	10.10%	8.00%	4.00%	3.00%	3.00%
Increase in Total Number of Members	1.50%	1.50%	1.50%	1.50%	1.50%
Growth in Investment Assets	4.30%	4.30%	4.30%	4.30%	4.30%

*For the purpose of this projection estimates have been made pending 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 2026/27 to 2028/29 will be influenced by the 2025 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 2023-2028, Report to Pensions Committee, 22 March 2023.

10.0 Schedule of Appendices

10.1 None.