Part I
Item No: 5
Main author: Tim Neill
Executive Member: Duncan Bell
All Wards

WELWYN HATFIELD BOROUGH COUNCIL
SPECIAL CABINET – 24 JANUARY 2017
REPORT OF THE EXECUTIVE DIRECTOR (RESOURCES, ENVIRONMENT AND CULTURAL SERVICES)

PENSION FUND TRIENNIAL VALUATION 2016

1 Executive Summary

1.1 Welwyn Hatfield Council employees are eligible to be members of the Local Government Pension scheme. This is a statutory condition of employment available to all local government employees. The terms and conditions are set nationally.

1.2 The Hertfordshire Local Government Pension Fund is administered by Hertfordshire County Council who has outsourced the operation to London Pensions Fund Authority (LPFA). The value of the assets and liabilities of the fund are assessed on a 3 yearly basis by the fund's actuary, Hymans Robertson.

1.3 The Council has received the draft results of the triennial valuation 2016, which is used to determine the employer contribution rates for the next three years, with effect from 1 April 2017.

1.4 The purpose of this report is to update members on the results of the 2016 valuation and to seek approval for a one-off lump sum contribution into the fund to help manage the annual contributions from the general fund.

2 Recommendation(s)

2.1 That Cabinet note the contents of this report and recommend to the Council an approach to manage the pension deficit based on:

- An additional lump sum payment of £1.286m in financial year 2016/17 to be paid into the pension fund on top of the current budgeted lump sum of £888k and to be funded from general fund and housing revenue account reserves.

- Future employer's contribution rate to the pension fund to be fixed at 18.3% of pay plus an annual lump sum to be determined by the actuary but no more than £1.1million in each of the next three years (2017/18 to 2019/20).

- Create an earmarked reserve for pension contributions and contribute £100k in each of the next three years (2017/18 to 2019/20) into this reserve.

3 Explanation

3.1 The Local Government Pension Scheme (LGPS) undergoes a financial valuation every 3 years; this is carried out by the appointed actuary, Hymans Robertson. The triennial valuation is an assessment of the financial health of the pension fund and the results of which is used to determine the contributions that the Council will need to pay to the pension fund from 1 April 2017 – 31 March 2020.

3.2 The previous triennial valuation was carried out based on the valuation date of 31 March 2013 (i.e. the 2013 Valuation); the WHBC fund was shown to be £33m in deficit or 73% funded. The latest 2016 valuation is based on an assessment of the fund as at 31 March 2016 and reflects the transfer of staff from the Community Housing Trust into the Council's fund. The result shows that the deficit position has improved and is now just under £25m and the funding level has increased to 83%. The assets and liabilities of the pension fund from the two valuations are summarised in the table below.

Table 1: **Triennial Valuation Results for the WHBC Fund**

	2010 Valuation	**2013 Valuation**	**2013 Valuation Adjusted***	**2016 Valuation**
	£000	**£000**	**£000**	**£000**
Assets	86,425	89,062	104,842	120,821
Liabilities	(120,855)	(122,319)	(136,666)	(145,805)
Deficit	**(34,430)**	**(33,257)**	**(31,824)**	**(24,984)**
Funding Level	**72%**	**73%**	**77%**	**83%**

*2013 adjusted to show a comparison following the transfer of staff from the Community Housing Trust into the Council's fund.

3.3 There are a number of key factors which have contributed to the improvement on the deficit position:

- Investment returns greater than expected (+£7m)
- Salary increases less than expected (+£2m)
- Contributions greater than cost of accrual (+£4m)
- Pension increases less than expected (+£4m)
- Lower life expectancy assumptions (+£1m)

3.4 However the positive financial impact highlighted above are offset by factors such as:

- interest charged on the pension fund deficit (-£5m)
- change in financial assumptions (-£7m)
- pensioner deaths fewer than expected (-£1m)

Options to address the pension fund deficit

3.5 The Actuary is required by Regulations to set a prudent contribution rate in order to ensure the long term solvency of the pension fund. A risk based approach is taken to assess the likely forecast for the fund and since 2010 a stabilisation methodology has been used to help smooth out changes to contribution rates over a 20 year period.

3.6 At the time of the last valuation in 2013 a lump sum payment of £1.211million was made to fix contributions at the same rate for a three year period. Now we have come to the end of that three year period the starting point for a level of contributions is at the higher point as if that lump sum payment was never paid.

3.7 At the current time the Council is paying 17% on payroll as the employer's contribution to the future benefit being accrued and is also paying an amount of £888k towards funding the structural deficit of the fund. The 2016/17 Council budget for total employer's contributions to the pension fund is therefore £2.4m. The Housing Trust is paying 20.1% on payroll and the current budget is just over £1m.

3.8 Following the release of results from Valuation 2016, the Actuary has proposed to increase the cost of the future accrual (i.e. the cost related to current active members) to 18.3% of pay for the next 3 years. They have, however, suggested three options in relation to the deficit payments over this period. These options are set out in the table below:

	Lump sum payment in each year				
Option	**Additional 2016/17**	**2017/18**	**2018/19**	**2019/20**	**Total over 3 years**
	£000	**£000**	**£000**	**£000**	**£000**
Option 1 - Additional lump sum in 2016/17	1,886	888	888	888	**4,550**
Option 2 – Additional lump sum in 2016/17	1,286	1,100	1,100	1,100	**4,586**
Option 3 – increased annual lump sum	0	1,457	1,557	1,657	**4,671**

3.9 Option 1 would require an additional one-off payment of £1.886m in 2016/17 over and above existing budgets, but contributions to the past deficit in the next 3 years would remain at existing budgeted levels of £888k in each year.

3.10 Option 2 would require an additional one-off payment of a smaller amount of £1.286million in 2016/17 over and above existing budgets and the annual contributions to the past deficit in the next 3 years would increase by £212k to £1.1million in each year.

3.11 Option 3 does not require any additional one-off payment in 2016/17 but would require a budget growth of £569k in 2017/18 and then a further £100k growth in the two following years.

3.12 The pension fund is able to achieve a much greater return on investments than the Council can achieve through its treasury strategy and an up-front investment therefore results in a slight reduction in the total payment over the three years. In particular option 1 results in the lowest total payment of £4.550million, option 2 with the next lowest at £4.586million and option 3 the highest at £4.671million. The difference being £121k between the highest and lowest option.

3.13 The Council will need to inform the Administering Authority (Hertfordshire County Council) the deficit recovery option chosen and will need to make the payment by 31 March 2017.

3.14 The Council is able to make additional lump sum payments into the pension fund in order to reduce the pension fund deficit. The actuary will then recalculate the required future contributions. Ordinarily an additional contribution would be charged to the general fund and housing revenue account. However, the DCLG can give special permission (called a Capitalisation Directive) for the contribution to be capitalised when an Authority applies for such permission and can demonstrate that the payment is necessary on affordability grounds.

3.15 The Council applied to DCLG for permission to capitalise a lump sum contribution in November but unfortunately this was unsuccessful. The response stating that "Any request we grant requires us to surrender to Treasury an equal sum of budget. Given this, before we recommend that Ministers agree a request we would need to be satisfied an authority has exhausted all local options available for increasing their revenue."

3.16 The only other option available to the Authority to capitalise the lump sum payment would be to use the special direction granted by the Secretary of State, called *"Flexible Use of Capital Receipts*", which allows the use of receipts from asset sales (excluding Right to Buy receipts) received in financial years 2016/17, 2017/18 and 2018/19 for transformation projects that generate ongoing revenue savings. Whilst a case could be made that the lump sum payment would meet the criteria for qualifying expenditure the Authority has not received adequate capital receipts over the last financial year. In 2016/17 a total of £337k of non right to buy capital receipts have been received.

3.17 A balance needs to be found of maximising the benefit of paying an additional payment upfront into the pension fund when it is affordable to do so and ensuring we are planning in our budgets to pay the annual lump sum each and every year over the 20 year period. For this reason option 2 is recommended. This option keeps the annual total contributions in each of the next three years in line with current budget forecasts for both the general fund and housing revenue account. Option 1 would increase the deficit for the housing revenue account in 2016/17 beyond current forecasts and effectively increase the borrowing requirement earlier than planned.

3.18 The additional lump sum of £1.286million will be split with 68% charged to the general fund and 32% to the housing revenue account. Based on current forecasts this is affordable. The general fund balance at 1 April 2016 was £7.9million and the housing revenue account balance was £13.9million. After in year expenditure and income and a payment of £1.286million the general fund would be forecast to be £6.9million at 31 March 2017 and the housing revenue account £9.9million.

3.19 It is likely that at the next triennial valuation the Council will be faced with a similar dilemma with a proposed increase in the annual contributions. To help smooth the impact of this future budget pressure it is proposed to create an earmarked reserve for pension contributions and make an affordable contribution in each year into this reserve. A contribution of £100k is affordable on current budget forecasts for option 2. If option 1 is chosen then it is recommended that the annual contribution is increased to £300k to ensure funds are available at the time of the next valuation for the likely increase in annual contributions. If a lump sum contribution is not approved the alternative option would be to increase the annual lump sum contribution in each of the next three years as per the amounts shown in option 3.

4 Legal Implication(s)

4.1 There are no legal implications in this proposal.

5 Financial Implication(s)

5.1 As detailed in the body of this report.

5.2 Option 2 will result in a total lump sum contribution over the three year period of £4.586million. This is £85k less than option 3 (no additional contribution in 2016/17) and reflects the estimated investment return on £1.286million calculated by the actuary over this three year period. For comparison, at a base rate of 0.25% the Council is not likely to generate more than around £10k of investment return on this amount over the same period.

6 Risk Management Implications

6.1 The risks related to this proposal are:

6.2 Investment return lower than expected – the market conditions could deteriorate over the next 3 years and may not reach the assumption set by the Actuary. Likelihood – medium, Impact - medium

6.3 Pension fund deficit deteriorates further at the next triennial valuation – option 1 effectively fixes the pension contribution rate and lump sum for the next 3 years, if the deficit position deteriorates at the next valuation, a large budget growth may be required in 4 years time. To help mitigate this it is proposed to make annual contributions into an earmarked reserve over the three year period. Likelihood – Medium, Impact – High.

7 <u>Security & Terrorism Implication(s)</u>

7.1 There are no known security or terrorism implications arising from the matters in this report.

8 <u>Procurement Implication(s)</u>

8.1 There are no procurement implications to consider in relation to pension contributions.

9 Climate Change Implication(s)

9.1 There are no climate change implications to this proposal

10 Link to Corporate Priorities

10.1 The subject of this report is linked to the delivery of all the Council's Corporate Priorities. The provision of a pension to past and present employees who contribute to the delivery of all Council priorities and the council has a duty to ensure the pension fund is fully funded over time.

11 Equality and Diversity

11.1 An Equality Impact Assessment (EIA) has not been deemed to be required in connection with the proposals that are set out in this report.

Name of author	Tim Neill 01707 357425
Title	Head of Resources
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