Report to the Finance and Performance Management Cabinet Committee

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Date of meeting: 14 November 2013

Epping Forest
District Council

Portfolio: Finance & Technology

Subject: Triennial Valuation of Pension Scheme

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Recommendations/Decisions Required:

1. **That the option to fund the deficit over 22.5 years is recommended to Cabinet; and**

2. **That subject to 1 above, Option B as set out in the Essex County Council consultation is recommended to Cabinet.**

Executive Summary:

Essex County Council has provided a number of different options for the Council's pension contributions for the next three years. The ongoing contribution is the same under each scenario but the deficit contributions vary. The first choice is whether to fund the deficit over 22 or 22.5 years. For both 22 and 22.5 years there is then a further choice to be made about the timing of the payments.

The option of 22.5 years is recommended as the reduction in CSB growth is felt to offer good value relative to the small extension in timescale for repaying the deficit. It should also be noted that this deficit recovery period is still ahead of the schedule set at the previous valuation.

The payment options allow for the deficit payment for the whole period to be paid at the start of the period, at the start of each year or on a monthly basis. Option B is recommended as it allows for the increase in deficit payments to be phased over the three years and takes advantage of the discount allowed for earlier payment without compromising the Council's cashflow position.

Reasons for Proposed Decision:

Essex County Council has set a deadline of mid-January for responses to their consultation and so it is necessary to evaluate and decide on one of the options.

Other Options for Action:

The shorter deficit recovery period could be adopted or Members could choose to either take full advantage of the front loaded payment option or not to front load at all.

Shortening the recovery period would increase CSB growth at a time when there are already considerable budget pressures. Fully front loading the payments could create difficulties in the management of the Council's cashflows and would limit the ability to fund other demands at short notice without borrowing.

Report:

Introduction

1. Essex County Council administers the Local Government Pension Scheme (LGPS) within Essex on behalf of the district councils and other various admitted bodies. In order to ensure that the fund is adequately resourced and able to meet its commitments, both now and in the future, valuations are conducted by actuaries on a triennial basis. The outcome of each valuation determines the contributions necessary for the following three years, to achieve the long term objective of the scheme's assets being at least equal to its liabilities.

2. Contributions are made up of ongoing amounts to fund future benefits and deficit contributions to make good the current position of the scheme being under funded. The ongoing contributions are set as a percentage of pay, whilst the deficit contributions are set as lump sums.

Valuation as at 31 March 2010

3. This valuation revealed that the improvement in funding level between 2004 and 2007 had been reversed and the scheme funding had reduced from 81 % to 71% (the value of the scheme's assets only cover 71% of the liabilities). There was some good news as the County confirmed that there was no need for any further increase in ongoing contributions, with a small reduction from 13.1% to 13% being suggested in all scenarios.

4. Deficit contributions had been calculated to recover the deficit over 20 years, with the maximum period allowed under the draft 2010 Funding Strategy being 30 years. Rather than move immediately to this position, and thereby limit any future flexibility, the County calculated extended deficit contribution periods based on maintaining stable contributions. For this Council the suggested period was 27 years and Member's chose this option, together with a phased increase in the deficit payments.

Valuation as at 31 March 2013

5. The valuation shows an improvement in funding level between 2010 and 2013 with the scheme now at a 77% funding level. This position is better than the previous valuation had anticipated and this is what has created the opportunity to recover the remaining deficit over a shorter period. If performance had been in line with expectations then three years on from a 27 year recovery we would be looking at a 24 year recovery.

6. Initially figures were provided for a 22 year recovery period, and these are provided at Annex 1. Due to the level of increases in annual contributions, the actuary was contacted and asked to provide an alternative scenario with the longest possible recovery period. As the scheme Funding Strategy does not allow for a reduction in contributions while the scheme is in deficit, the longest period allowable is 22.5 years, see Annex 2. The difference in annual increases is summarised below using Option A for both recovery periods –

Financial Year	Increase – 22 Years	Increase – 22.5 Years	Difference
2014/15	£30,006	£2,877	£27,129
2015/16	£65,237	£64,006	£1,231
2016/17	£68,196	£66,910	£1,286

7. Given the level of net savings already required for 2014/15, an option with a £27,129 lower increase is welcome. This is particularly the case as the recovery period is only

extended by 6 months and the overall position is still 1.5 years better than had been anticipated previously.

8. If the 22.5 year recovery period is assumed, it is then necessary to choose between the five options set out in Annex 2. As Option C has the same total payments over three years as Option A but frontloads the increase in payments, Option A is preferable to Option C. Similarly, Option D has the same total payment as Option B but frontloads the increase and so Option B is preferable to Option D. This gets us to the position where the Options A, B and E need to be compared.

9. Options A and B both phase in the increase in payments over three years, the difference is that A spreads payments throughout each year whilst B requires the deficit amount to be paid in one lump in April each year. Option E has one deficit payment for the entire three year period at the start of the three years. As Options B and E have frontloaded payments some element of discount is allowed which reduces the total amounts to be paid.

10. The different options are set out on Annex 3. The comparison shows that total payments are £123,056 lower for B than A and that this equates to an approximate discount of 5.56%. As 5.56% greatly exceeds the 0.73% currently being earned on temporary investments Option B is preferable to Option A. Paying £1.4 million in one amount instead of spreading it over the year will be manageable within the cashflow as there is still sufficient time to adjust for this.

11. The second comparison on Annex 3 evaluates Options B and E. It shows that Option E provides a discount rate of 5.8% which is slightly higher than the 5.56% for Option B. This means E is the most attractive option in terms of total payments necessary. However, making £4.1 million available to pay in April 2014 has implications for the Council's cashflow. Firstly, in order to make the funds available it would be necessary to negotiate an early break in one of the two long term investments of £5 million each. This would require the agreement of the other counterparties involved and may necessitate some compensation. Secondly, the Council is currently working on a number of projects that may require significant funds at short notice and taking £4.1 million out of the cashflow would make it difficult to meet any further demands. Therefore, in considering both the total payments necessary and the Council's cashflow Option B is the recommended option.

Ongoing Contributions

12. Having concentrated on the deficit payments, as that is the subject of the decision, it is worth mentioning the ongoing payments as these have increased. The ongoing contribution rate is expressed as a percentage of pensionable pay and is increasing from 13% to 15.9%, in monetary terms this is an increase of £395,114. The comments of the scheme actuary on ongoing contributions are given below –

An ongoing contribution rate is needed to obtain the level of contributions required to meet the cost of new pension benefits and this is usually based on the same assumptions as are used for the deficit.

For the 2013 valuation, the ongoing rate has been affected by the following.

- *Membership movements – this is very employer specific. With all else equal the younger the employer's members the lower the cost as the contributions can be invested for longer. Overall we have seen the membership age slightly. In the case of Epping Forest their active membership has aged by one and half years increasing the ongoing rate.*

- *Financial assumptions – outlook of investment returns has deteriorated since the last funding valuation pushing up the cost of the benefits. This has been the main reason for the increase in the ongoing rate.*

- *Change in assumptions – after performing an analysis of the mortality over the intervaluation* *period we have adjusted the mortality assumption to be more in line with the observation that members will live longer in retirement, increasing the cost of pensions benefits.*

- *Change of benefits – The effect varies by employer but for Epping Forest, the change to the 2014 scheme is a cost. In general we have seen a slight increase in the rate due to the accrual rate of 1/60ths moving to 1/49ths for each year of pensionable service.*

- *50/50 scheme – we have made the assumption that 10% of members will opt for the 50/50 scheme (pay half the contributions to receive half the benefits). This reduces the ongoing rate by almost 1% of salary.*

Capitalisation of Deficit Payments

13. In some previous years it was possible to gain capitalisation directions, in part or whole, for the pension deficit payments. The qualification criteria for obtaining a capitalisation direction have tightened in recent years and there is no realistic prospect of being able to obtain a direction at this time.

Resource Implications:
The increase in ongoing contributions is partly off-set by the reduction in deficit payments. If Option B is adopted there will be a saving of £36,336 in 2014/15 to credit to the District Development Fund. This is followed by Continuing Service Budget growth of £25,891 in 2015/16 and £65,050 in 2016/17. Both the saving and the growth will need to be apportioned between the Housing Revenue Account and the General Fund.

Legal and Governance Implications:
There are no legal or governance implications.

Safer, Cleaner, Greener Implications:
There are no environmental implications.

Consultation Undertaken:
None.

Background Papers:
None.

Impact Assessments:

Risk Management

The options recommended are intended to balance the financial and cashflow risks faced by the Council.

Equality and Diversity:

Did the initial assessment of the proposals contained in this report for relevance to the Council's general equality duties, reveal any potentially adverse equality implications?	No
Where equality implications were identified through the initial assessment process, has a formal Equality Impact Assessment been undertaken?	

What equality implications were identified through the Equality Impact Assessment process?
N/A

How have the equality implications identified through the Equality Impact Assessment been addressed in this report in order to avoid discrimination against any particular group?
N/A