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REPORT TO EXECUTIVE

PORTFOLIO AREA: GOVERNANCE AND RESOURCES

Date of Meeting: **19 January 2011**

Public

Key Decision: **Yes** **Recorded in Forward Plan:** **No**

Inside Policy Framework

Title: **DRAFT PENSION FUND VALUATION**
Report of: **Assistant Director (Resources)**
Report reference: **RD74/10**

Summary:

This report updates the Executive on the draft Actuarial Valuation of the Cumbria Local Government Pension Scheme as at 31 March 2010 in respect of the City Council. The financial implications arising from the valuation, as set out within the report, need to be considered and approved. Appendix A gives a summary of the present state of the pension fund based upon the most recent annual report, supplemented by more recent information received as part of the actuarial process.

Recommendations:

It is recommended that the Executive

(i) Notes the information received from the County Council;

(ii) Makes recommendations on the preferred option with regard to deficit recovery periods as set out in the body of the report.

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Note: in compliance with section 100d of the Local Government (Access to Information) Act 1985 the report has been prepared in part from the following papers: Draft Actuarial Valuation from Cumbria County Council December 2010, and Cumbria CC Pension Fund Report 2009/10.

CITY OF CARLISLE

To: The Executive RD74/10
19 January 2011

DRAFT PENSION FUND VALUATION

1. BACKGROUND INFORMATION AND OPTIONS

1.1 The City Council is an employing authority within the Local Government Pension Scheme (LGPS) as administered by Cumbria County Council (the administering authority). This is a funded scheme which means that both the Council and its employees, who are members of the scheme, pay contributions into a fund independent of the Authority's own assets. The employer's contribution rate is determined every three years following an actuarial valuation of the assets and liabilities of the fund. Different rates will apply to different employers dependent upon the future pension liabilities that they will each have to accommodate.

1.2 The Pension Fund is revalued every three years and the draft results of the actuarial valuation as at 31 March 2010 have recently been received from the Fund's Actuary. The new contribution results arising from the valuation will apply for the three year period commencing 1 April 2011.

1.3 A range of options has been provided for the contribution rates. Fixed contributions rates have been provided based upon a default 19 year deficit recovery period with options to extend this to 25 years (but no longer). However a shorter recovery period can be adopted if required. Any increase in contribution rates from April 2011 can be implemented on a phased approach over a maximum 3 year period.

1.4 The draft results also provide options with regard to the future funding of past service costs. These have previously been recovered as a percentage of the authority's pensionable pay i.e. the 2010/11 contribution rate of 17.4% was 12.9% for future service costs and 4.5% for past service costs. The actuary have now provided 2 options; (1) to continue funding past service costs as a percentage of pensionable pay, or (2) to pay an lump sum expressed as a £ amount.

1.5 The budget made an assumption of a 1.5% increase in the employer's contribution rate over each of the next three years which equated to £206,000 per annum. However early indications were that the increase could be much higher and could be as much as 4.5% but changes announced by the government in June altered the way in which public sector pensions would be increased and altered the basis from RPI to CPI which has resulted in a lower cost to Authorities. In the event, the suggested increase is slightly below the initial forecast with the fixed rise on a 25 year recovery period coming in at 0.9% over the next three years. However the rate for the 19 year recovery period at 2.7% is above the forecast. All of these figures include assumptions for recovery of the deficit i.e. past service costs. The table below sets out the estimated cost of the various options and these are compared to the sums that have been set aside as contained in the revenue budget. It should be noted that these sums are all based upon the current level of payroll costs with no specific provision made for any changes arising from the transformational process, shared services or inflation etc.

	2011/12	2012/13	2013/14	Para

Current Rate – 17.4% Future service – 12.9% Past service – 4.5%	**Over a 20**	**year recovery**	**period**	
Phased Rate	Available upon request	Available upon request	Available upon request	1.6
Fixed Rate Default rate (19 years) • Future service • Past service Extended rate (no more than 25 years) • Future service • Past service Annual Cost: • Default rate • Extended rate	**20.1%** 11.8% 8.3% or £ lump sum **18.3%** 11.8% 6.5% or £1.003m £ 380,000 127,000	20.1% 11.8% 8.3% or £ lump sum 18.3% 11.8% 6.5% or £1.051m £ 380,000 127,000	20.1% 11.8% 8.3% or £ lump sum 18.3% 11.8% 6.5% or £1.101m £ 380,000 127,000	1.7 1.8 1.9
Budget Provision	£ 206,000	£ 206,000	£ 206,000	
Variation Cost/(Saving) Default rate Extended rate	**£** **174,000** **(79,000)**	**£** **174,000** **(79,000)**	**£** **174,000** **(79,000)**	

1.6 Phased Rates.
It is recommended that the Council retains its current policy of making a fixed rate contribution over three years rather than moving to a phased rate of increase over this period. There are advantages in retaining the fixed rate contribution in terms of budget stability i.e. the Council will not need to find additional year on year savings over the next three years as compared to the agreed budget provision in 2010/11.

1.7 **Option 1**: 19 year recovery period.

Although this option is in line with the Council's current policy, it is clearly not affordable given the pressures on the revenue budget and therefore this option is not recommended.

1.8 **Option 2**: Up to 25 year recovery with the deficit recovered as a percentage of pensionable pay. The up to 25 year option clearly produces a greater level of saving at this stage than the 19 year projection as the cost is spread over a longer period. There is also an argument that the actuarial exercise is based on a view of future liabilities over a 25 year period.

The financial implications of changing to an extended recovery period (no longer than 25 years) with a fixed contribution rate, and the deficit recovered as a percentage of pensionable pay, are summarised in the table below:

CUMBRIA LOCAL GOVERNMENT PENSION SCHEME			
2010 Valuation Contribution Rates (25 Year Fixed)			
	2011/12 £000	2012/13 £000	2013/14 £000
Current Rate 17.4%	2,447	2,447	2,447
Proposed Rate 18.3%	2,574	2,574	2,574
Additional Cost	127	127	127
Current Budget Provision	206	206	206
(Contribution to)/Call on Reserves	(79)	(79)	(79)

1.9 **Option 3**: Up to 25 year recovery with the deficit paid as a lump sum. The actuary have provided options with regard to the funding of the past service deficit. This has previously been recovered as a percentage of the overall pensionable pay but the figure has also been expressed as a cash lump sum amount as show in the table below. This option prevents contributions to the scheme falling due to reductions in staff numbers which would impact on the 2013 actuarial valuation. In times of reducing staff establishment this option mitigates future pension liability increases as the past service contribution does not decrease as staffing numbers fall.

The financial implications of changing to an extended recovery period (no longer than 25 years) with a fixed contribution rate, with the deficit being recovered as a lump sum, are summarised in the table below:

CUMBRIA LOCAL GOVERNMENT PENSION SCHEME
2010 Valuation Contribution Rates (25 Year Fixed)

	2011/12 £000	2012/13 £000	2013/14 £000
Current Rate 17.4%	2,447	2,447	2,447
Proposed Rate Future service (11.8%) Lump sum	 1,660 1,003 2,663	 1,660 1,003 2,663	 1,660 1,003 2,663
Additional Cost	216	216	216
Current Budget Provision	206	206	206
(Contribution to)/Call on Reserves	10	10	10

The lump sum amount will be subject to annual increases in line with CPI plus 1.5% and will increase to £1.051m and £1.101m for 2012/13 and 2013/14 respectively. However for the purposes of this report, no inflation has been assumed to ensure like for like comparisons.

1.10 As can be seen from the worked examples, in the last 3 years since the last revaluation the cost of past service on a like for like basis almost doubles from 4.5% to 8.3%. Without ring fencing the deficit as suggested the past service rate, based on a lower employee base, will become unmanageable.

1.11 Both options 2 and 3 can be accommodated within the existing budget provision, with option 2 generating more savings at £79,000 per annum. However option 3, although more costly to the authority, would mitigate any further past service pension liabilities arising in future actuarial valuations and for this reason, it is recommended that option 3 be approved. The additional £10,000 costs can be funded from the increase in the 2011/12 taxbase equating to £16,000 per annum.

2. CONSULTATION

2.1 Consultation to Date –The issue of the triennial review has been raised in various reports brought to members during the budget process but the results of the actuarial valuation were only received towards the end of December 2010 and for this reason could not be presented to the Executive until this meeting.

3. RECOMMENDATIONS

It is recommended that the Executive

(i) Notes the information received from the County Council;

(ii) Makes recommendations on the preferred option with regard to deficit recovery periods as set out in the body of the report.

4. REASONS FOR RECOMMENDATIONS

To ensure that the Cumbria Local Government Pension Scheme is adequately resourced in the medium term in order that all the employing bodies can meet their future liabilities falling on the Fund. In particular, actuaries have assessed the contributions that the City Council will have to make in the next three years in order to be able to adequately fund these liabilities in the longer term. Various options have been provided for making these contributions and the option 3 is the recommended option. In terms of balancing risk management and affordability, this is also regarded as the most advantageous option.

5. IMPLICATIONS

- Staffing/Resources –
- Financial – As set out in the report.
- Legal – None
- Corporate – None
- Risk Management – The 25 year recovery period is considered to be a reasonable one in terms of meeting future liabilities and matching liabilities against the resources of the fund.
- Equality Issues – None
- Environmental – None
- Crime and Disorder – None
- Impact on Customers – None

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Appendix A

The Cumbria Local Government Pension Scheme

The Cumbria Local Government Pension Scheme is one of around 100 separate local authority pension funds within the UK. These funds provide pensions for most local authority employees. The actuarial reserves of the pension funds are owned by the fund members and pensions paid out under the scheme are chargeable to the pension funds and not to the authorities that administer them. As at 31 March 2010, there were approximately 42,000 members of the Cumbria Pension Fund of which over 18,000 were active members, over 10,600 members had preserved pensions and around 13,800 members and dependants are currently in receipt of benefits. 85 separate employers are members of the scheme as either scheduled bodies e.g. the City Council or as admitted bodies e.g. several of the community centres in Carlisle.

Local authority pension funds are funded schemes unlike, for example, police and fire service pensions which are met out of current expenditure on a pay as you go principle. Teachers' pensions, in contrast, are provided through a nationally funded scheme administered by 'Teachers Pensions' on behalf of the Department for Children, Schools and Families.

The Cumbria Fund has a diversified portfolio, a strategy which spreads the risk associated with any particular form of investment while facilitating the growth potential of the Fund. At as 31 March 2010, the Fund was invested in the following classes of assets:

Investment Assets	**£000m**	**%**
U K Equities	£348m	28%
Overseas Equities	£334m	26%
Fixed Interest Bonds	£254m	20%
Alternatives	£110m	9%
Index-Linked Bonds	£129m	10%
Property	£74m	6%
Cash	£15m	1%
Total	**£1.264m**	**100%**

The Fund is currently managed by eight separate fund managers which, again, is a strategy designed to spread risk in terms of the performance achieved by each manager.

In 2009/10, the Cumbria Fund achieved an overall return of 28.4% as compared to the local authority universe average of 35.2%. The slight under performance was attributed to the fund managers adopting a defensive strategy towards the equity market, a decision that should lead to an over performance this year in the light of the falls in the stock market. Performance is most sensibly viewed over a period of several years and set out below are comparative performance figures over the past decade.

	Fund Return per annum	Ranking (1-100)
Year to 31 March 2010	28.4%	93
3 years to 31 March 2010	1.9%	44
10 years to 31 March 2010	4.6%	15

Performance has varied over the past decade but an overall ranking of 15 in the ten year period indicates that the Cumbria Fund has performed well.

Three years ago the Fund had a funding level of 81% which relates to the ratio between a fund's assets to its future liabilities. As at 31 March 2010, this level had dropped to 79%. However the scheme is designed to become fully funded over the long term and short term deviations are to be expected. Therefore, as the fund currently remains significantly short of this target, employer contribution rates are unlikely to fall in the years ahead unless the Fund's investments achieve an exceptional performance to enable the 100% level to be achieved ahead of current actuarial projections.