Pension Contributions

Cabinet Member for Finance, Procurement and Revenues and Benefits

Date:	5 April 2022
Agenda Item:	4
Contact Officer:	Anthony Thomas
Tel Number:	01543 308012
Email:	Anthony.thomas@lichfielddc.gov.uk
Key Decision?	**YES**
Local Ward Members	Full Council

Lichfield district council

Cabinet

1. Executive Summary

1.1 A contribution rate review that sets a contribution strategy for each employer is currently undertaken, by the Pension Fund Actuary on a three yearly basis.

1.2 The last valuation took place in 2019, covered 2020/21 to 2022/23 and had a funding level of **97%**.

1.3 The next valuation will occur in 2022 and will cover the three year period 2023/24 to 2025/26.

1.4 The Pension Authority's Funding Strategy Statement requires a contribution strategy to achieve more than a **68%** probability of success outcome of the Council's pension pool being fully (**100%**) funded.

1.5 A strategy is based on the following approach set by the Actuary:

- A **payroll element** (Primary Rate) of pensionable pay.
- A **past service element** (Secondary Rate) is fixed irrespective of the level of pensionable pay to reduce the risk of shortfalls occurring in pension contributions given payrolls are reducing.

1.6 However for the 2022 valuation, the Actuary has changed the balance of the strategy to increase the primary rate (from 16.2% to 22%) and reduce the secondary rate.

1.7 This change is because the primary rate is no longer sufficient to cover future pension payments for current employees due to higher inflation and lower asset returns relative to the last valuation.

1.8 To aid financial planning, the Actuary has produced provisional modelling for the 2022 valuation. However to finalise the valuation, two decisions need to be taken by each Member Authority:

- The contribution strategy to be adopted and;
- The payment frequency either in three annual instalments or in one payment at the start of 2023/24 at a discount of circa **7%**.

1.9 The Approved Budget assumes that the Council will pay the Pension Fund Actuary's preferred strategy because there is a risk that the alternative strategy will not be available and it reduces the risk of unsustainable increases for future taxpayers.

1.10 Staffordshire Pension Authority have requested a decision on the preferred strategy by April 2022.

2. Recommendations

2.1 To approve that the contribution strategy is based on the Pension Fund Actuary's alternative strategy for the period 2023/24 to 2025/26.

2.2 Subject to the approval of 2.1, to approve the upfront payment of the secondary element in advance (option 2B) in April 2023 and to update the Medium Term Financial Strategy for 2023/24 to 2025/26.

2.3 To note that the MTFS for 2026/27 onwards will be based on the Actuary's current preferred strategy and an upfront payment (option 1B).

3. Background

3.1 The Pension Fund Actuary undertakes a triannual valuation to check progress against the plan to ensure the Council's Pension Fund liabilities are fully funded. The contribution strategy produced by the Pension Fund Actuary must attempt to close any deficit over a set period of time.

3.2 The modelling takes place over a 20 year horizon with a review after 17 years. The contribution strategy will be revisited after 3 years and the administering authority retains the right to change employer's strategies at that time.

3.3 The 2019 valuation showed a funding level of **c97%** (assets compared to liabilities) for the Lichfield District Pool with the Staffordshire Pension Fund overall being **99%**.

3.4 The next valuation will formally take place in 2022 and will cover the three year period 2023/24 to 2025/26 and **all Authorities currently have a deficit which ultimately must be paid**.

3.5 The contribution strategy is twofold with a percentage of pensionable pay known as the primary rate and a fixed monetary amount related to the past service element known as the secondary rate.

3.6 The primary rate is intended to cover future pension payments for current employees and will increase. The Actuary has indicated that this is because of higher inflationary projections and lower asset returns relative to previous valuations.

3.7 The secondary rate is a fixed monetary amount and is intended to fund past service deficits.

3.8 The Actuary has changed the balance of the strategy to increase the primary rate (from **16.2%** to **22%**) and reduce the secondary rate although the rate should have increased in previous valuations but the 2013 rate was retained for administrative convenience.

3.9 The overall rate as a percentage of the modelled payroll is **30.1%** (District and Borough Councils in Staffordshire range from **29.4%** to **43.7%** with an average of **35.4%**).

3.10 In addition, under the contract and pension guarantee through a pass through agreement, Freedom leisure are part of the Lichfield District pension pool and pay a fixed contribution rate for Transfer of Undertakings (Protection of Employment) (TUPE) employees.

3.11 This fixed rate is aligned to the proposed primary rate and this will therefore mean for this valuation there is no material impact on the Council's level of contributions.

3.12 The Approved Revenue Budget is based on the Actuary's preferred strategy because:

- **There is a risk that the alternative strategy will not be available and;**
- **It reduces the risk of unsustainable increases for future taxpayers.**

3.13 The combination of the overall rate of **30.1%** and a 2019 funding level of **c97%** mean the Actuary has offered for this valuation, two alternative contribution strategies:

1. The Actuary's **preferred strategy** where contributions continue to increase annually.
2. An **alternative strategy** provided by the Actuary with frozen (apart from an allowance for pay awards) contributions.

3.14 In addition, there is a further option of a **voluntary strategy** based on option 1 with higher voluntary contributions.

3.15 There are also two alternative payment options available for the secondary or past service element:

1. In **three annual payments**.
2. In **one upfront payment** in April 2023 resulting in a payment discount of circa **7%**.

3.16 These different options are compared in the alternative options section of this report with a voluntary strategy aligned to the Actuary's preferred strategy.

Alternative Options

Option 1 - Preferred Strategy of the Pension Fund Actuary (Increases of 1% for 3 years followed by +/- 1%)

Advantages

- It is the Pension Fund Actuary's preferred strategy of stepping up contributions if this is affordable.
- It maximises the potential return (with discounts of circa 7%) on investment available from the pension fund.
- The risk of a future unsustainable increase beyond the three year period is reduced.
- Probability of success is **86%** in achieving the funding strategy outcome.
- Average of worst 5% of outcomes and downside risk is **54% - green and acceptable**.[1]

Disadvantages

- The cost is higher than the Approved MTFS.

Financial Implications:

Details	2023/24	2024/25	2025/26	Total
Annual Payment	841,000	962,000	1,088,000	2,891,000
Upfront Payment	**2,694,000**			**2,694,000**

Option 2 - Alternative Strategy provided by the Pension Fund Actuary (3 year freeze with pay award allowance, followed by +/-1%)

Advantages

- The cost is within the Approved MTFS with savings.
- Probability of success is **85%** in achieving the funding strategy outcome.
- Average of worst 5% of outcomes and downside risk is **51% - green and acceptable**.

Disadvantages

- It is not the Pension Fund Actuary's preferred strategy.
- The risk of a future unsustainable increase beyond the three year period is increased.
- The next valuation could coincide with the ending of transitional arrangements for Local Government Finance Reform thereby creating a significant budget pressure.

Financial Implications:

Details	2023/24	2024/25	2025/26	Total
Annual Payment	746,000	767,000	788,000	2,301,000
Upfront Payment	**2,150,000**			**2,150,000**

Consultation	There has been no consultation specifically about this Report due to the statutory nature of calculations.

[1] The Actuary uses the following downside risk criteria to assess strategies: **Green** is **at least 50%** and acceptable, **Amber** is **between 45%** and **50%** and has downside risk in the margin of acceptability and **Red** is **less than 45%** and has downside risk that is unacceptable.

Financial Implications	See below

Financial Implications

<u>Cash Flow Implications</u>

1. The single upfront payment in April 2023 would mean over the three years there would be less money available to invest resulting in a loss of investment income at a rate of **1.0%** for non-strategic investments.

<u>Accounting Requirements and Budgetary Implications</u>

2. In the event that the Council decides to make an upfront payment, the entire payment would not be shown in the 2023/24 revenue budget.
3. This is because accounting requirements are that payments are matched to the three years covered by the valuation.
4. To comply with the accounting requirement and reflect that a prepayment of future year's payments has taken place, adjustments are allowed to be made to the Pension Fund balances in the Council's Balance Sheet.
5. The budgetary implications can be identified by comparing the two strategies annual accounting based payments plus the loss of investment income to the Approved Budget:

	2022 Pension Valuation Period				**Next Valuation**
	2023/24	**2024/25**	**2025/26**	**Total**	**2026/27**
Approved Budget	**2,879,140**	**3,063,890**	**3,245,470**	**9,188,500**	**3,426,200**
Option 1A - Preferred with Annual Payments					
Primary Rate	2,133,580	2,187,560	2,237,240	6,558,380	2,281,980
Secondary Rate	841,000	962,000	1,088,000	2,891,000	1,214,000
Loss of Investment Income	0	0	0	0	0
Cost / (Saving)	**95,440**	**85,670**	**79,770**	**260,880**	**69,780**
Option 1B - Preferred with Upfront Payment					
Primary Rate	2,133,580	2,187,560	2,237,240	6,558,380	2,281,980
Secondary Rate	783,690	896,450	1,013,860	2,694,000	1,131,270
Loss of Investment Income	23,000	12,000	0	35,000	23,000
Cost / (Saving)	**61,130**	**32,120**	**5,630**	**98,880**	**10,050**
Option 2A - Freeze with Annual Payments					
Primary Rate	2,133,580	2,187,560	2,237,240	6,558,380	2,281,980
Secondary Rate	746,000	767,000	788,000	2,301,000	809,000
Loss of Investment Income	0	0	0	0	0
Cost / (Saving)	**440**	**(109,330)**	**(220,230)**	**(329,120)**	**(335,220)**
Option 2B - Freeze with Upfront Payment					
Primary Rate	2,133,580	2,187,560	2,237,240	6,558,380	2,281,980
Secondary Rate	697,040	716,670	736,290	2,150,000	755,910
Loss of Investment Income	17,000	9,000	0	26,000	17,000
Cost / (Saving)	**(31,520)**	**(150,660)**	**(271,940)**	**(454,120)**	**(371,310)**

6. The additional budgetary pressure resulting from the loss of investment income will be managed within existing approved budgets.

Approved by Section 151 Officer	Yes

Legal Implications	The Council would need to engage with the External Auditor to agree the accounting implications.
Approved by Monitoring Officer	Yes/no*

Contribution to the Delivery of the Strategic Plan	The Medium Term Financial Strategy (MTFS) underpins the delivery of the Strategic Plan.

Equality, Diversity and Human Rights Implications	None identified in this report.

Crime & Safety Issues	None identified in this report.
Environmental Impact	None identified in this report.

GDPR / Privacy Impact Assessment	None identified in this report.

	Risk Description & Risk Owner	Original Score (RYG)	How We Manage It	Current Score (RYG)
A	The provisional figures change	Green Likelihood – Green Impact - Yellow	Liaison with pension fund with any changes reflected in Money Matters Reports and the Medium Term Financial Strategy	Green Likelihood – Green Impact - Yellow
B	The adoption of the alternative freeze strategy means the Authority needs to consider: • That the probability of much higher increases from 1 April 2026 onwards would increase. • The contribution strategy will be reviewed in three years' time and the Actuary retains the right to change employers' strategies at that time. • Any increases potentially could coincide with transition on changes to Local Government Finance ceasing creating a significant budgetary pressure. • The fairness between current and future generations of taxpayers given a freeze strategy delays payments until later years.	Yellow Likelihood – Yellow Impact - Yellow	Implementation of the Pension Fund Actuary's recommended preferred contribution strategy	Green Likelihood – Green Impact - Yellow

	Risk Description & Risk Owner	Original Score (RYG)	How We Manage It	Current Score (RYG)
C	The pension fund contribution levels increase the cost of directly employing staff and impact on the viability of alternative delivery models	Yellow Likelihood – Yellow Impact - Yellow	The Budget principles indicate: Council will ensure that all growth in the staffing establishment will be fully understood through robust business cases in order to ensure our resources match service and customer needs. Growth will usually be allowed where costs are offset by external funding, savings or additional income. Additionally, the Business Case for Alternative Delivery Models will need to consider the pension risks retained by the Council through pension guarantees.	Yellow Likelihood – Green Impact - Yellow

Background documents

- Medium Term Financial Strategy (MTFS).
- Contribution rate review for the Staffordshire Pension Fund dated 18 February 2022 plus supplementary information provided by the Actuary.

Relevant web links