Business Plan 2023 - 2026 - Appendix 2 - Budget 2023/34

1. Background Information

1.1 Due to the volatility that exists within most areas of the Pension Fund Account, preparing a budget for the Pension Fund is complex. The budget can be considered across three sections with different characteristics; member cashflows, management expenses and investment income. The three sections are set out in more detail below.

1.2 Member cashflows include contribution inflows from members and employers, benefit payments and transfer to and from other pension funds. These items represent the fund's most significant cashflows but lie mostly outside the control of the Fund. Whilst the Fund has a degree of control during the contribution rate setting process, it has no control over staffing decisions by employers, pay awards, inflation-linked benefit increases or pensioner longevity. Monitoring of these costs should therefore be focused on their significant impact on fund cashflows.

1.3 Management expenses include administration, investment and oversight and governance costs. These are the costs linked to the management of the Fund and represent the one area in which the Fund can exercise a significant degree of cost control. However, it should be remembered that the Fund has a large number of statutory responsibilities which must be discharged which will inevitably incur a degree of cost. Monitoring of these costs should be focused on ensuring that the Fund receives value for money from its suppliers and on cost reduction where this can be done without significant negative impacts on quality of service.

1.4 Investment income is dependent on investment performance but also on the asset classes to which the Fund allocates. The Fund's significant allocation to equities means that investment income levels have been highly volatile in the past; however, with a shift towards cashflow-generating assets such as private debt, the Fund's investment income should become more predictable over time. Monitoring of investment income should therefore be linked back to the Funds overall net cashflow and how this can be influenced by the Committee's investment strategy decisions.

1.5 Changes in the market value of investments can have a significant impact on the Fund's income statement; however, they are not considered within the Pension Fund budget for two reasons. Firstly, changes in market value will not impact cashflow if the changes are unrealised (i.e. the Fund retains the assets). Secondly, the Fund wishes to avoid reliance on asset sales to generate cashflow, as this is not a prudent long-term investment strategy. Including this item in the budget could therefore give a distorted picture of income and encourage reliance on asset sales.

2. 2023/24 Budget

2.1 The 2023/24 budget is provided below and sets out the Fund's expected income and expenditure across the categories outlined in Section 1.

2.2 Net cash inflows from members are expected to decrease from a forecast £88,832k in 2022/23 to £85,251k in 2023/24. The key driver of this is the Council's reduction in its contribution rate from 30% to 27%; this however is partially offset by a budgeted 4% pay increase for staff.

2.3 Transfers in for 2022/23 are forecast at £7,357k and transfers out at £11,210k Accurately forecasting and budgeting for these elements is challenging as they are driven by member behaviour; in the absence of other information the estimated outturn from 2022/23 has been used for the 2023/24 budget.

2.4 Key assumptions made around member cash inflows are as follows:

- Employee and employer contributions are assumed to be increased by a 4.00% pay increase for Hackney employees for 2023/34, as per the Council's budgeted pay increase assumption.

- No material change in active member numbers is assumed, with no significant movement between contribution bands

- Employer contribution rates have been adjusted for 2023/24; the most significant change is a reduction in Hackney's contribution rate from 30% to 27% of pensionable pay. This has driven the reduction in employer contributions.

2.5 The most significant change to budgeted member cash outflows is the 10.1% CPI uplift which will be applied to member benefits from April 2023. This has increased member cash outflows from a forecast £80,816k in 2022/23 to a budgeted £87,813 for 2023/24. This has a significant and lasting impact on the Fund's cashflows.

2.6 Key assumptions made around member cash outflows are as follows:

- Annual pension and lump sum payments are assumed to increase by 10.1% in line with the Consumer Prices Index (CPI), driving the significant forecast increase in pensions payable.

- No material change in pensioner numbers, profile or number of deaths is assumed.

- No significant change to lump sum commutation rates is assumed, thus maintaining the pre-existing balance between annual pensions payable and lump sum payments.

2.7 It should be remembered that member cashflows are sensitive to changes in the membership profile of the Fund (e.g. the balance between active, deferred and pensioner members). As set out in 2.4 and 2.5, no allowance has been made in the budget for changes in this balance as the in-year impact cannot be reliably estimated. However, over the longer term, the Fund is maturing and the ratio of pensioner and deferred to active members is increasing. Over time, this effect will reduce the Fund’s net cash inflows, as contribution payments reduce relative to benefits paid out.

2.8 Management expenses are forecast to decrease slightly from £15,486k in 2022/23 to £15,296k in 2023/24. The Fund has seen very significant increases in administration costs during 2022/23 as a result of price increases on its third party administration contract during the year, including a commitment to contribute a £370k one off cost to upgrade the Fund’s administration system. The GMP and McCloud projects also resulted in significant increases to administration costs. These are forecast to reduce slightly for 2023/24 as the cost burden of the GMP project reduces.

2.9 Oversight and governance costs are budgeted to be £917k in 2023/24 compared to a forecast £868k for 2022/23. The increase is largely the result of anticipated pay increases for internal staff and cost increases for the Fund’s suppliers as a result of high inflation.

2.10 Given the difficulty of producing a reliable estimate, investment management costs are forecast on the basis of the 2022/23 outturn. The majority of investment management fees are charged on the basis of assets under management; as these can fluctuate significantly during the year depending on market conditions, producing a reliable estimate is challenging. Significant increases in asset values during the year would improve the Fund’s funding position but would result in an increase in investment management fees relative to budget. It should be noted that the majority of investment management costs do not impact on the Fund’s cashflows, as they are deducted directly from the value of the Fund’s investment portfolio.

2.11 Volatility in the Fund’s investment income level makes producing a reliable full year estimate challenging; the forecast 2022/23 outturn has therefore been used as the budgeted amount for 2023/24. As the Fund shifts its investment strategy towards income generating assets, the level of investment income is expected to increase.

2.12 Overall, the 2023/34 budget indicates a significant reduction in the Fund’s budget before investment performance, from a forecast £11,782k in 2022/23 to £1,358k in 2023/24. The most significant changes are to member cashflows; the Fund is required to increase member benefits by 10.1% in line with CPI (12 months to September 2022), whilst the Council, as the Fund’s main employer, has reduced its contribution rate from 30% to 27% as a result of improvements in the funding position.

2.13 A gradual reduction in the Fund’s net membership cashflows has long been expected as the Fund matures and the funding position has improved, allowing reductions in employer rates. As such, the Fund has made gradual changes to its investment strategy over the past 6 years to shift towards income generating assets. However, the very significant inflationary increase in member benefits has significantly accelerated the pace of change.

Pension Fund Budget & Forecast

	2022/23	2022/23	2022/23	2022/23	2023/24
	Budget	**December Outturn**	**FY Forecast**	**Estimated Variance**	**FY Budget**
	£'000	£'000	£'000	£'000	£'000
Members Income					
Employers Contributions	(62,561)	(49,326)	(65,768)	(3,207)	(61,559)
Employees Contributions	(14,945)	(11,780)	(15,707)	(762)	(16,335)
Transfers In	(4,984)	(5,518)	(7,357)	(2,373)	(7,357)
Total Members Income	**(82,490)**	**(66,624)**	**(88,832)**	**(6,342)**	**(85,251)**
Members Expenditure					
Pensions	52,850	43,341	57,788	4,938	63,625
Lump Sum Commutations & Death Grants	11,750	8,754	11,673	(77)	12,852
Transfers Out	7,399	8,408	11,210	3,811	11,210
Refund of Contributions	183	109	145	(38)	145
Employer Exit Credits	0	0	0	0	0
Total Members Expenditure	**72,182**	**60,612**	**80,816**	**8,634**	**87,831**
Net (additions)/withdrawals from dealings with members	**(10,308)**	**(6,012)**	**(8,016)**	**2,292**	**2,580**
Management Expenses					
Administrative Costs	1,766	1,038	1,839	73	1,618
Investment Management Expenses	13,020	9,482	12,779	(241)	12,779
Oversight & Governance Costs	973	657	868	(105)	917
Total Management Expenses	15,759	11,177	15,486	**(273)**	**15,314**
Net (surplus)/deficit from operations	**5,451**	**5,165**	**7,470**	**2,019**	**17,894**
Investment Income					
Investment Income	(19,252)	(11,658)	(19,252)	0	(19,252)
Budget before Investment Performance	**(13,801)**	**(6,494)**	**(11,782)**	2,019	**(1,358)**