



London Borough of Hammersmith & Fulham

AUDIT, PENSIONS AND STANDARDS COMMITTEE

26th September 2013

PENSION FUND CASHFLOW POSITION

Report of the Executive Director of Finance and Corporate Governance

Open Report

Classification: For Decision

Key Decision: No

Wards Affected: All

Accountable Executive Director: Jane West, Executive Director of Finance and Corporate Governance

Report Author: Nicola Webb, Tri-borough Pension Fund Officer

Contact Details:

Tel: 020 7641 4331

E-mail:

nwebb@westminster.gov.uk

1. EXECUTIVE SUMMARY

- 1.1. Due to changes in Pension Fund membership over the last few years, the Pension Fund now has more cash being paid out in benefits every month than it has contributions coming in. This will result in the Pension Fund being overdrawn on its bank account in October 2013, because investment income is currently automatically reinvested by the fund managers. The Local Government Pension Scheme regulations do not allow Pension Funds to sustain an overdraft for a prolonged period.
- 1.2. This report proposes a short term solution of withdrawing the cash required to maintain a positive cash balance from the UK equity portfolio, (the highest overweight compared to target) in October and proposes the decision of what cash is withdrawn in the remainder of 2013/14 is delegated to the Executive Director of Finance and Corporate Governance, in consultation with the Chair of the Audit, Pensions and Standards Committee. It also highlights the work which will be commencing with officers and the Fund Actuary to determine the longer term trend to inform the next investment strategy review post the actuarial valuation.

2. RECOMMENDATIONS

- 2.1. That the Committee agree to £5m being withdrawn from the Majedie UK equity portfolio in October 2013 to cover the expected overdraft.
- 2.2. That the Committee delegate to the Executive Director of Finance and Corporate Governance, in consultation with the Chair of the Audit, Pensions and Standards Committee, the decision about how much, when and from which portfolio cash be withdrawn during the remainder of 2013/14. The decision is to be made on the basis that the cash required is withdrawn from the portfolio with the highest overweight position compared to target at the time of the requirement for withdrawal.

3. REASONS FOR DECISION

- 3.1. The Local Government Pension Scheme (Management & Investment of Funds) Regulations 2009 only permit Pension Funds to maintain an overdraft for a period of 90 days and therefore in the absence of any other source of cash, it is necessary to withdraw cash from a portfolio held by one of the fund managers to avoid a prolonged overdraft.
- 3.2. Withdrawing from the portfolio with the highest overweight balance compared to target will ensure the Fund does not move any further away from the target. As the precise cashflow position for the remainder of 2013/14 is uncertain, the delegation to the Executive Director (in consultation with the Chair of this Committee) will ensure that not only will the cash balance remain positive, but also that the Fund remains fully invested for as long as possible.

4. INTRODUCTION AND BACKGROUND

- 4.1. Until recently the Pension Fund has been able to fund pension benefit payments from contributions collected from employees and employers. However, the membership profile of the Fund has been changing over the last few years, as the number of pensioners has increased and the number of active contributing members has reduced. This change has led to pension payments increasing, contributions reducing and more cash going out every month than there is coming in.
- 4.2. The Local Government Pension Scheme (Management & Investment of Funds) Regulations 2009 permit pension funds to make use of overdraft facilities for the purpose of paying benefits due under the scheme. However, an overdraft can only be maintained for a period of 90 days. The Fund has a £5m overdraft facility in place with Northern Trust, the Fund's bankers.
- 4.3. This report proposes a short term way to fund the expected cash deficit over the next 12 months and highlights the work required in the coming months to forecast the longer term trend and to determine how best to address the Fund's cashflow requirements going forward.

5. PROPOSAL AND ISSUES

Membership trend

- 5.1. The following table shows the membership of the Fund and how it has changed over the last 5 years. The number of active contributors has fallen 17% over 5 years while deferred members and pensioners have increased by 28% and 15% respectively.

Table 1: Membership

	31 Mar 2008	31 Mar 2009	31 Mar 2010	31 Mar 2011	31 Mar 2012	31 Mar 2013
Actives	4,572	4,297	4,176	4,064	3,835	3,782
Deferreds	4,343	4,714	4,900	5,217	5,409	5,546
Pensioners	3,812	3,903	4,067	4,174	4,265	4,379
Total	12,727	12,914	13,143	13,455	13,509	13,707

- 5.2. This trend has resulted in part from cuts to local government budgets and hence staffing levels. This has seen many active members become either deferred beneficiaries or pensioners. In the Local Government Pension Scheme (LGPS) as a whole, the picture is very similar. According to the latest data available from the Communities and Local Government Department, the number of active members in the LGPS fell by 5% between 31st March 2008 and 31st March 2012, while the number of deferred members and pensioners increased by 35% and 19% respectively.

Cashflow – Contributions, Benefits and Expenses

- 5.3. Table 2 below shows the impact of the membership trend described above. It can be seen that contributions have been falling and that there has been an increase in the on-going pension payments to the larger number of pensioners. It also shows that the figures for transfer values in and out vary considerably year by year and therefore can make the difference between the Fund being in surplus or deficit in any one year.

Table 2: Contributions, Benefits & expenses

	2008/09 £000	2009/10 £000	2010/11 £000	2011/12 £000	2012/13 £000
Contributions	31,034	32,097	32,540	30,182	29,629
Pensions	-19,828	-20,811	-21,417	-24,284	-26,525
Lump Sums	-4,297	-7,665	-6,430	-6,526	-5,546
Expenses	-3,335	-3,692	-4,668	-3,977	-3,065
Net TVs in/(out)	-1,384	-1,718	2,053	-669	-4,574
Net cash in / (out)	2,190	-1,789	2,078	-5,274	-10,081

- 5.4. The bottom of the table shows net cash in or out in each financial year. It can be seen that the deficit has grown particularly in the last two years.

Investment Income

- 5.5. The investments the Fund holds earn income and the policy to date has been for the Fund to re-invest this income into further investments, as it has not been required to fund pension payments. Private equity has been the exception to this where the distributions have been used to either fund further private equity drawdowns or to cover deficits in the past, particularly in 2009/10 and 2011/12. Table 3 below shows the value of investment income in recent years and shows the cash surplus in each year once investment income is included.

Table 3: Net cash position including investment income

	2008/09 £000	2009/10 £000	2010/11 £000	2011/12 £000	2012/13 £000
Net contrib less benefits & exps	2,190	-1,789	2,078	-5,274	-10,081
Investment Income	11,829	9,510	7,624	9,038	10,508
Overall net cash in	14,019	7,721	9,702	3,764	427

- 5.6. The table shows that in 2012/13 the payments out were very close to the sum of contribution and investment income for the first time and it is likely that in 2013/14 it will be the case again and it may even be the case that there is a cash deficit after investment income. This means that the cashflow situation has moved considerably closer to the position where assets will need to be sold in order to fund all of the Fund's obligations.

Action taken in 2012/13

- 5.7. In 2012/13 £10m was withdrawn from the equity managers to fund the cash deficit in that year. This decision was taken under delegated powers by the Executive Director of Finance and Corporate Governance, on the basis that both equity portfolios were above their target weightings. This decision was reported to the Committee as part of the quarterly Pension value and investment performance report on 14th February 2013.

Current position

- 5.8. Table 4 overleaf shows the cashflow in 2013/14 to date. The Council paid the lump sum deficit contribution into the Fund in April, which has ensured the cash balance has remained positive to date.

Table 4: Cashflow in 2013/14 to date

	April 13 £000	May 13 £000	Jun 13 £000	Jul 13 £000	Aug 13 £000
Balance b/f	-674	5,064	3,568	2,860	1,681
Contributions	9,130	1,647	1,775	1,751	1,806
Pensions	-2,196	-2,238	-2,270	-2,236	-2,219
Lump Sums	-976	-408	-192	-348	-212
Expenses	-2	-635	0	-362	-557
Net TVs in/(out)	-218	138	-20	16	-105
Net cash in / (out)	5,738	-1,496	-708	-1,179	-1,287
Balance c/f	5,064	3,568	2,860	1,681	394

The future

- 5.9. A forecast for the remainder of 2013/14 and the first six months of 2014/15 is set out in the first table in Appendix 1. This makes no assumptions about changes to the level of benefits paid out or the value of contributions coming in. It can be seen that without any action being taken, the Fund bank account will be overdrawn in October this year and that it is forecast that this will grow through the remainder of 2013/14 to an overdraft of around £9m by the end of March 2014. In April, the Council is expected to pay the lump sum deficit contribution into the Fund which will ensure the overdrawn position does not start to deteriorate again until September 2014.
- 5.10. The trend of pension benefits exceeding contributions is expected to continue and this represents a fundamental shift in the way the Fund views the funding of benefit payments. In the past they were considered an issue for the long term only and the investment strategy reflected this. Now there is a requirement for the Fund's investments to provide cash regularly to pay benefits and so this needs to be built into the Fund's planning going forward.
- 5.11. It is therefore proposed that officers work with the Fund Actuary to forecast the longer term trend for cashflow as part of the valuation work already being undertaken. This information can then be fed into the review of investment strategy planned to take place when the valuation results are known to ensure there is a clear strategy going forward for funding benefit payments.

6. OPTIONS AND ANALYSIS OF OPTIONS

- 6.1. As discussed in paragraph 4.3 above, the Fund is only permitted to be overdrawn for a period of 90 days and the forecast in Appendix 1 shows that there will be an overdraft for a prolonged period if no action is taken. In order to cover the overdraft expected for the remainder of 2013/14,

withdrawals of cash from portfolios being managed by the fund managers will be required, as no other sources of cash are available. Table 5 below shows the value of each of the portfolios at 31st July 2013 and how the proportions in each compare to the target weightings set out in the current investment strategy.

Table 5: Investment Portfolios

	Value of portfolio 31 July 13	% of portfolio	Target %	Variance from target
Majedie UK Equities	£191.0m	25.7%	22.5%	+3.2%
MFS Global Equities	£179.1m	24.1%	22.5%	+1.6%
Barings DAA	£125.9m	27.9%	30.0%	-2.1%
Ruffer DAA	£81.2m			
LGIM Matching	£88.1m	20.4%	25.0%	-4.6%
Goldman Matching	£63.5m			
Invesco Private Equity	£7.7m	1.9%	0.0%	+1.9%
Unicap Private Equity	£6.3m			
TOTAL	£742.8m	100.0%	100.0%	0.0%

- 6.2. It can be seen that the UK equity portfolio managed by Majedie is further above the target allocation than any other portfolio following their recent good performance. It is proposed to withdraw £5m in October 2013 from Majedie as their portfolio is currently the one which exceeds the target weighting the most. This would bring their weighting down to 25.2% (if nothing else changed), still further above the target than any other portfolio. It would be possible to withdraw cash from any of the Fund's portfolios, except the private equity ones, but this would move the Fund further from the target weightings set out in the investment strategy.
- 6.3. To ensure the Fund remains fully invested for as much time as possible, it is proposed that another cash sum is withdrawn during 2013/14. Based on the forecast set out in the table in Appendix 1 above, this is likely to be a further £4m in January 2014. The second table in Appendix 1 shows the impact this would have on the cash position.
- 6.4. However, the cashflow forecasts in this report are forecasts only and therefore may not turn out to be correct. Transfers in and out are particularly unpredictable and the timing of distributions from the private equity investments is uncertain. It is therefore proposed that the decision about the precise amount to be withdrawn, when and the portfolio(s) it is withdrawn from during the remainder of 2013/14, is delegated to the Executive Director of Finance and Corporate Governance, in consultation with the Chair of this Committee, on the basis that the cash required is withdrawn from the portfolio with the highest overweight position compared to target at the time of the requirement for withdrawal.

7. CONSULTATION

7.1. Not applicable.

8. EQUALITY IMPLICATIONS

8.1. Not applicable.

9. LEGAL IMPLICATIONS

9.1. Not applicable.

10. FINANCIAL AND RESOURCES IMPLICATIONS

10.1. The comments of the Executive Director of Finance and Corporate Governance are contained within this report.

11. RISK MANAGEMENT

11.1. Not applicable

12. PROCUREMENT AND IT STRATEGY IMPLICATIONS

12.1. Not applicable

LOCAL GOVERNMENT ACT 2000 **LIST OF BACKGROUND PAPERS USED IN PREPARING THIS REPORT**

No.	Description of Background Papers	Name/Ext of holder of file/copy	Department/ Location
1.	Spreadsheet calculating cashflow forecast.	Nicola Webb 020 7641 4331	Tri-borough Pensions Team, Westminster City Hall

LIST OF APPENDICES:

Appendix 1 – Cashflow forecast September 2013 to September 2014.

Cashflow forecast September 2013 to September 2014**Cashflow forecast if no action taken**

	Sep13 £000	Oct13 £000	Nov13 £000	Dec13 £000	Jan14 £000	Feb14 £000	Mar14 £000	Apr14 £000	May14 £000	Jun14 £000	Jul14 £000	Aug14 £000	Sep14 £000
Balance b/f	394	180	-1,580	-2,690	-3,800	-5,560	-6,670	-8,430	-2,590	-3,700	-4,810	-6,570	-7,680
Contributions	1,700	1,700	1,700	1,700	1,700	1,700	1,700	9,300	1,700	1,700	1,700	1,700	1,700
Pensions	-2,300	-2,300	-2,300	-2,300	-2,300	-2,300	-2,300	-2,300	-2,300	-2,300	-2,300	-2,300	-2,300
Lump Sums	-350	-350	-350	-350	-350	-350	-350	-350	-350	-350	-350	-350	-350
Net TVs in/(out)	-160	-160	-160	-160	-160	-160	-160	-160	-160	-160	-160	-160	-160
Expenses	0	-650	0	0	-650	0	-650	-650	0	0	-650	0	0
Net cash in/(out) in month	-1,110	-1,760	-1,110	-1,110	-1,760	-1,110	-1,760	5,840	-1,110	-1,110	-1,760	-1,110	-1,110
Private Equity distributions	896												
Balance c/f	180	-1,580	-2,690	-3,800	-5,560	-6,670	-8,430	-2,590	-3,700	-4,810	-6,570	-7,680	-8,790

Cashflow forecast assuming inflows from fund managers

	Sep13 £000	Oct13 £000	Nov13 £000	Dec13 £000	Jan14 £000	Feb14 £000	Mar14 £000	Apr14 £000	May14 £000	Jun14 £000	Jul14 £000	Aug14 £000	Sep14 £000
Proposed inflows from fund managers		5,000			4,000								
Revised cash balance	180	3,420	2,310	1,200	3,440	2,330	570	6,410	5,300	4,190	2,430	1,320	210