Leicestershire County Council

LOCAL PENSION COMMITTEE - 6 SEPTEMBER 2024

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PENSION FUND – BUDGET MONITORING UPDATE

Purpose of the Report

1. The purpose of this report is to update the Local Pension Committee (LPC) on the Leicestershire County Council Pension Fund (Fund) budget and forecast for 2024/25 and forecast for future years.

Background

2. To demonstrate good governance, the Pension Fund's Budget and Business Plan were presented to the Local Pension Board (LPB) for consideration on 7 February 2024 and to the LPC on 8 March 2024.

3. The 2024/25 Budget is designed to provide sufficient funding to maintain the level of service required by scheme members and Fund employers over the current financial year.

4. The LPC approved the Pension Fund budget and annual business plans for investments and administration for the Fund.

Pension Fund Budget

5. Is it important to note the Pension Fund budget is independent of the Council's budget and its finances are managed separately. The Director of Corporate Resources is the Fund's LGPS (Local Government Pension Scheme) senior officer who is responsible for the delivery of the LGPS function and as such must be able to ensure that the Fund is sufficiently resourced. The Pension Fund budget has been considered independently taking into account the needs of the service. Whilst the Good Governance project has not been finalised, Phase 3 of the report includes the following proposal:

   - Each administering authority must ensure their committee is included in the business planning process. Both the Committee and LGPS senior officer must be satisfied with the resource and budget allocated to the deliver the LGPS service over the next financial year.

6. The current budget covers the financial year 2024/25 with projected estimates up to 2026/27. A summary of the budget is shown below including current forecasts for 2024/25 to 2026/27. The 2024/25 to 2026/27 forecast has been updated and is expected

to be sufficient to meet the Fund's statutory requirements. The LGPS Central 2024/25 costs show a reduction due to a forecast used for the original budget that has now been agreed between LGPS Central and the administering authorities which is lower than originally proposed.

7. The annual management fees for 2024/25 have been updated and are higher than the budget based on a higher average assets under management assumed for 2024/25 and the higher annual management fee experience in 2023/24. The transaction fee for 2024/25 and subsequent years has also been reforecast higher again based on higher assets under management and expected higher fees arising from transacting into private markets. A nominal increase in performance fees reflects that more of the Fund is exposed to mandates that exhibit performance fees although this part of the total investment fee is highly subjective.

Budget Heading	2023/24 Budget £'000s	2023/24 Actual £'000s	2024/25 Budget £'000s	2024/25 Forecast £'000s	2025/26 Forecast £'000s	2026/27 Forecast £'000s
Investment Management Expenses (split into three areas)						
o Management	25,792	27,968	27,518	30,298	33,187	35,310
o Transaction	6,642	13,251	7,087	9,651	10,020	10,661
o Performance	10,500	9,268	10,000	10,000	10,500	11,000
Sub Total	**42,934**	**50,487**	**44,605**	**49,949**	**53,707**	**56,972**
LGPS Central costs (Governance, operator running costs, product development)	1216	1292	1298	1160	1350	1417
Staffing	1,551	1,776	1,848	1,848	1,913	1,980
IT costs	520	476	530	530	540	550
Actuarial costs	150	97	150	150	400	150
Support Services / other	630	690	650	650	670	700
Total	**47,001**	**54,818**	**49,081**	**54,286**	**58,580**	**61,769**
% of assets under management	**0.85%**	**0.92%**	**0.78%**	**0.84%**	**0.88%**	**0.87%**
Average assets under management in year	**5,500,000**	**5,939,220**	**6,265,488**	**6,434,000**	**6,680,089**	**7,107,494**

Investments

8. The Fund holds no reserves and has no capital expenditure planned.

9. The total budget being forecasted is £54.3million for 24/25. Increase versus the budget are explained at point 7 of this paper. A reduction of £0.2million from the 2024/25 budget is included for the LGPS Central budget . A breakdown of the expenses is set out below.

Investment Management Expenses

10. Investment Management Expenses have been split into three sections; management fees, transaction costs and performance fees. There could be deviations from these

numbers given the changes within fee structures and changes of investment manager. For example, reduced investment manager fees, as a direct or indirect result of asset pooling or increased performance fees if mandates which are subject to performance fees when product investment returns are ahead of the hurdles required.

11. Investment management fees are expected to increase over time given they are based on assets under management. Each mandate has its own level of fees agreed with some types of investment incurring higher management fees than others. For example, passive listed equity is one of the cheapest in terms of management fees given the reduced management required compared to private credit where regular and extensive management time is required in order to originate and manage the underlying loans.

12. Given the Fund is moving towards a higher allocation to private markets and its assets under management has been increasing, management fees as a percentage of assets under management increases. To mitigate this, pooling of private market investments via LGPS Central allows the Fund to access these strategies at a lower cost than the Fund may have if acting alone whilst improving the Fund's diversification. The transition towards higher allocations to private markets will also mean at times, transaction costs will be higher in some years. Over time this is expected to normalise.

13. Total investment costs were higher than the budget for 2023/24 by circa £7.5million. The primary driver was an increase in transaction fees (+£6.6million) and management fees (+£2.2million) versus the budget.

    - A portion of the management fee increase (+£2.2million) is explained by higher average assets under management through the year, which as explained earlier would naturally increase management fees. Another driver of higher management fees is the move towards private market investments which are more costly versus the public market investments where the Fund was divesting from.

    - The transaction fee increase (+£6.6million) versus budget is largely due to a £4.5million increase in transaction fees associated with the Fund's emerging market debt investment. Compared to the previous year the EMD fund transacted around double the value of purchases and sales. The Fund also incurred a one off £3million charge (stamp duty) for direct property purchases whilst building up an allocation to this asset class. The Fund, on advice from Hymans Robertson and agreed by the LPC decided to divest from Central EMD Fund and have exposure to the emerging market debt class via the Central multi asset credit fund which can invest in emerging market debt.

14. The performance fee estimate can be highly variable given the Fund would not expect meaningful performance fees when general market returns are depressed. At the time of setting the budget for 2023/24 markets were far more stable and as such a prudent estimate was included within the 23/24 budget based on the prior year forecast. For future years, the performance fee estimate is likely to rise as the Fund invests more into private market funds which usually attract performance fees.

15. Assets under management (AUM) has been estimated to grow over time plus an estimate for net contributions which is the sum of employer and employee contributions less pensions and lump sums paid. As the AUM increases, the monetary value of

investment managers fees will increase given investment management fees are paid based percentages of asset values.

LGPS Central costs oversight, governance and product development

16. The budget for LGPS Central and costs borne to the Fund, concerning oversight, governance and product development have been agreed based on last year's budget plus Retail Price Index (RPI) as at September 2023.

17. The Fund’s expected share of costs has been estimated at £1.2million. The governance costs for LGPS Central are split equally between the eight member local authorities. Operator running costs are split based on assets under management and product development costs are allocated based on products that our Fund has expressed an interest in. As time has passed the level of product development fees has reduced as fewer Central products have been bought forward. There is likely to be continual product development as Partner Funds have their own investment advisors with differing allocations and strategies being approved each year.

Administrating authority costs

18. The costs to run the Leicestershire LGPS fund are at present in line with the budget at £3.2million. Future years costs are expected to rise marginally in line with inflation being the main driver. Total costs incorporate staffing, IT costs, actuarial costs and support services. Staffing costs incorporate an increase of 6% and 3.5% in staffing related costs in the following two years in line with the County Council’s assumptions.

19. The salary spend in 2023/24 was higher than anticipated by £0.2million. This was primarily due to higher than anticipated inflation and pay award and the increased work associated with McCloud. Additional resources have been included in the budget for 2024/25 to continue work on McCloud.

20. Officers have now agreed to purchase an Integrated Service Provider (ISP) from Heywood. This will enable the Fund to comply with the new national Pensions Dashboard programme, which will allow people to view all their pensions in “one single Dashboard”. The ISP is required so that the Fund can link its data from the Heywood pensions administration system to the Dashboard. The cost of the ISP will not take effect until 2025/26 as the connection will not be required until then.

21. Actuarial charges are budgeted at £150,000 each year, and at £400,000 during Fund valuation years. The next valuation is the 31 March 2025 so the 2025/26 budget for actuarial costs is £400,000 although elements of the valuation work will be brought forward into 2024/25 to assist administration.

22. Support Services were made up of Strategic Financial and Operational Finance charges, East Midlands Shared Services, Internal Audit, Central Print, Democratic Services and Legal Services.

23. The actual spend for 2023/24 was £60,000 over budget. This is primarily due to higher inflation and greater amounts of work provided by Central Print. Other costs include

annual subscriptions, tracing service charges, Officer qualifications, training for Officers, Committee and Board Members.

24. The 2024/25 budget for Support Service is £650,000 which is £40,000 less than the anticipated spend for 2023/24 primarily due to a reduction in East Midlands Shared Services payroll charge.

Budget Summary

25. Over 90% of the budget is spent on investment manager related expenses. Given that most investment manager expenses are based on percentage of assets under management, an increase in asset values, for example an increase in stock market returns, will result in higher management fees paid in total.

26. Total investment management costs are volatile (given they include transaction and performance costs) and are likely to be higher than expected if investment performance exceeds assumptions and performance fees are paid. Therefore, the costs detailed in the report could significantly change if returns exceed expectations.

Recommendation

27. It is recommended that the Local Pension Committee note the increased forecast for the current and future years.

Equality Implications

28. There are no direct implications arising from the recommendations in this report. The Fund incorporates financially material Environmental, Social and Governance (“ESG”) factors into investment processes. This has relevance both before and after the investment decision and is a core part of the Fund’s fiduciary duty. The Fund will not appoint any manager unless they can show evidence that responsible investment considerations are an integral part of their decision-making processes. This is further supported by the Fund’s approach to stewardship and voting through voting, and its approach to engagement in support of a fair and just transition to net zero. There are no changes to this approach as a result of this paper.

Human Rights Implications

29. There are no direct implications arising from the recommendations in this report. The Fund incorporates financially material Environmental, Social and Governance (“ESG”) factors into investment processes. This has relevance both before and after the investment decision and is a core part of the Fund’s fiduciary duty. The Fund will not appoint any manager unless they can show evidence that responsible investment considerations are an integral part of their decision-making processes. This is further supported by the Fund’s approach to stewardship and voting through voting, and its approach to engagement in support of a fair and just transition to net zero. There are no changes to this approach as a result of this paper.

Appendices

None

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