

Report To: **GMPF MANAGEMENT PANEL**

Date: 10 March 2017

Reporting Officer: Sandra Stewart, Executive Director of Pensions
Paddy Dowdall, Assistant Executive Director of Pensions,(Local Investments and Property)

Subject: **GMPF BUDGET 2017/2018 AND FUTURE MEDIUM TERM FINANCIAL PLANNING**

Report Summary: This report seeks approval of the Management Panel for the a 2017/18 expenditure budget for GMPF with a medium term financial plan. (An updated version will be included in the Annual report for 2016/17).

Recommendations: That the Management Panel

1. approves the expenditure budget for 2017/18.
2. approves the Medium Term Financial Plan
3. notes that the Medium Term Financial Plan will be updated for information available including profiling of employer contributions and Fund value at 31 March and included in the Annual Report for 2016/
4. notes that the Executive Director of Pensions intends to review all budgets in 17/18 and undertake a zero based budget approach.

Financial Implications: The financial implications are set out in the report. There is a projected increase in expenditure which supports strategic change at the Fund to optimise net risk adjusted returns on investments and to provide efficient administration in order to ultimately minimise the contributions paid by employers.

(Authorised by the Section 151 Officer)

Legal Implications: There is a duty on the Fund to achieve best value and consequently the Panel need to ensure through such monitoring that value for money is being achieved.

(Authorised by the Solicitor to the Fund)

Risk Management: Failure to properly manage and monitor the Fund's budgets may lead to a reduction in service standards for scheme members or employers, or a loss of confidence in the management of the fund.

ACCESS TO INFORMATION: **NON-CONFIDENTIAL**

This report does not contain information which warrants its consideration in the absence of the Press or members of the public.

Background Papers: The background papers used in the preparation of this report were:

1. The 2016/2017 Financial Ledger
2. Budget Working Papers

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1. INTRODUCTION

- 1.1 This report seeks the Management Panel's approval to an expenditure budget for GMPF for 2017/18 alongside a medium term financial plan. The employer funding group have previously considered the budget and approved it to be taken forward to the Management Panel.
- 1.2 The medium term financial plan is essentially dependent upon the assumptions in the Funding Strategy Statement, and the out-turn is largely subject to financial markets and their impact on investment performance.
- 1.3 The medium term financial plan 2017-2020 will be finalised for the annual report following approval of budget and more up to date information on position at 31 March 2017.

2. OVERVIEW AND CONTEXT

- 2.1 The Fund, following approval on assumptions and process by the Management Panel, produced a medium term financial plan and medium term expenditure plan in its annual report and accounts for 2015/16. These are set out below. It is intended to re-set the medium term financial plan following the completion of the actuarial valuation for 2017-2020.

Medium term Financial Plan (as included in Annual Report 2015/16)

	2016/17	2017/18
	£m	£m
Fund Size at Start of Year	17,325	17,937
Fund Size at end of Year	17,937	18,539
Pensions Paid	737	778
Contributions received	545	548
Transfers	0	0
Net Cash-flow	-191	-230
Management Costs	28	29
Investment Income	329	345
Increase in Value of Investments	503	516
Net Return from Investments	832	861
Net Change in Fund	612	602

They key observations are that:

- Investment returns are the key determinant of the financial position.
- The fund has a negative cash-flow from pensions paid less contributions and the trend is for this to increase as the Fund matures.
- The management costs are small relative to Fund size and annual cash flows.

- 2.2 The medium term expenditure plan is set out in the table below, the key features are the planned increases in investment management costs premises and staffing to support the strategic changes at the Fund, approved by the Management Panel and to provide for future development.

Medium term Expenditure Plan as at March 2016

Type of Expenditure	2015/16 outturn	2016/17 Budget	2017/18 Budget as at March 2016
	£000	£000	£000
Staff Costs	5,253	5,808	5,924
Investment Management & Professional Fees	11,156	19,294	20,220
Accommodation	466	817	833
Other Services	2,076	1,793	1,829
Central Establishment Charges	379	379	379
TOTAL	19,330	28,091	29,186

- 2.3 The projected out turn for the expenditure for 2016/17 is considered in another item on this agenda. There is a significant underspend largely due to one off investment matters.
- 2.4 The out-turn for the medium term financial plan is likely to result in a significantly higher than predicted Fund value due to the strong investment performance to date in the financial year although there is a risk of investment performance volatility in the final 3 months.

3. BUDGET CHANGES 2017/18 FROM BUDGET FOR 2016/17

- 3.1 The table overleaf shows the changes in the 2017/18 budget from the 2016/17 budget. The significant changes are investment management, staffing and property. These are specifically dealt with in the tables below.
- 3.2 For investment management the budget reflects; firstly the implementation of new investment strategies designed to optimise net risk adjusted returns on investments, detailed below, including allocations to credit and global equities and re-negotiation of passive management fees which results in a significant saving, and there is an allowance for asset value growth in line with long term expectations.
- 3.3 The Panel has previously agreed to make two incremental changes to the Fund's arrangements with a view to improving the prospects for returns in the future. The first of these changes saw the appointment of Investec in March 2015, with a mandate building up to 5% of Main Fund assets focusing solely on Global Equity, reflecting the increased significance of overseas equity investment for the Fund.
- 3.4 The second incremental change was for the creation of a new portfolio of broadened debt related investments representing 5% of Main Fund assets. The aim of this new mandate is to achieve broadly equity like returns, with lower volatility.
- 3.5 Hymans point out a number of downsides to the introduction of the new Global Equity mandate: there will be an increase in the number of manager relationships and consequential monitoring and governance costs, and there is likely to be a net increase in investment management fees. In addition, the scope for value to be added by tactical allocation between assets by the active securities managers will reduce. However, it is believed that the scope for higher manager skill to be deployed, and the increased diversification, will outweigh the 'negatives' even after taking account of the additional direct costs.

	£000
Credit manager for full year	950
Investec Additional funding	400
L&G changes	(1015)
Capital negotiation	100
UBS negotiation	(120)
Property management fees charged to individual properties	(395)
Total	(80)

- 3.6 For staffing the changes reflect the requirements to oversee the new investment strategies deployed by the Fund and to provide administration services for the Fund following a step change in complexity and volume, for example the fact that there are now effectively 3 different schemes being administered, the increase in the number of employers, and the need to calculate GMP's. There is also an increase of 2% to reflect pay awards and the on costs have increased due to changes in national insurance and employer pension contributions. The impact of these changes is shown in the table below.

	£000
Changes to Senior Management structure	(160)
Review of Administration	220
Review of Investments	60
Review of local investments largely recharged to GLIL)	80
Graduates/apprentices to be deployed across Fund	120
Pay Awards 2016/18 2% plus increments	150
National Insurance increase	22
Pension Contributions increase	120
Total	612

- 3.7 The other changes in the budget for 2017/18 from 2016/17 are detailed in the table overleaf. The most significant item is an increase of £743,000 from £100,000 to £843,000 for professional fees in relation to setting up an FCA regulated vehicle as a result of pooling. This is a provision that may not be fully utilised but reflects the upper range of estimates. Management Panel is yet to consider final pooling proposals. Property costs are increased to reflect an increase in rates and the full charges for facilities management and use of the building. The other significant items are a growth in income from charges to GLIL and property and the other items are relatively minor.
- 3.8 **Appendix 1** shows the budget estimate for 2017/18 incorporating these proposed changes. The overall expenditure budget moves by £1.4m from £28.1m to £29.5m.

Expenditure	Change £000	Significant Components of Changes £000
Staffing Costs	612	Dealt with in section 3.3
Training and Insurance	(7)	Reduction in requirements
Publications and Subscriptions	32	4 Price increase in existing subscriptions 4 Law Society Regulatory Fees 24 Scheme Advisory Board
Travel and Subsistence	+5	Small change to reflect increased prices and activity
Premises	293	(22) Utilities 109 Facilities Management 153 Increase in rent charge 53 rates
Postage, Printing, Telephone	(40)	(46) Printing - decrease in external printing (28) Telephone - net decrease, mainly due to Admin reduction in required provision +34 Postage - increase based on trends observed in 2016/17
Office Equipment and Software	(27)	18 MFD additional charges (40) reduction in spending on hardware following transition year (5) reduction in legal case management system
Investment Advisory Expenses	16	Appointment of additional adviser
Bank Charges and Nominee Fees	28	(2) Decrease in bank charges based on trend 30 Increase in custody fees predicted due to mandate changes
Managers and Professional Fees	779	743 Pooling Costs (80) Investments total change (see section 3.2) 50 GMP reconciliation 60 e-learning video production 40 provision for addition abortive External fees on local investments (60) reduction in investment consultancy fees for specific exercises compared to last year (9) Ombudsman 5 Increased HSBC Accounting fees 30 Hymans fees for employer matters
Performance Measurement Services	26	(32) cease of WM Services 52 Addition of Portal Evaluation plus portfolio analytics service 6 Additional IPD costs to reflect additional analysis
Communications	30	Inflation and external production of May payslips
CEC	16	4% increase overall following freeze for past years reflecting the Funds increased use of services
Recovery of Management and Legal Fees	(345)	(225) investment management charges to GLIL and (20) Increased accountancy charges to GLIL (100) increased Legal Services charges to property development
Commission Recapture	-	No change predicted
Total	1,418	

4. ASSUMPTIONS FOR MEDIUM TERM FINANCIAL PLANNING

4.1 The assumptions for medium term financial planning are taken from the Funding Strategy Statement and are detailed in the table below.

Fund Investment Return	4.2% per annum over the long term
Inflation	CPI Bank of England Forecast (around 2.5% central case in November)
Pay Inflation	1%
Employer Payroll	From actuarial valuation
Pensioner Profile	From actuarial valuation
Budget	2017/18 taken forward

5. MEDIUM TERM FINANCIAL PLAN 2017-2020

5.1 The proposed medium term financial plan for 2017-2020 is shown below.

	2017/18	2018/19	2019/20
	£m	£m	£m
Fund Size at Start of Year	21,000	21,781	22,583
Fund Size at end of Year	21,781	22,583	23,423
Pensions Paid	690	718	727
Contributions received	619	634	648
Transfers	0	0	0
Net Cash-flow	-71	-84	-79
Administration Costs	30	30	30
	0	0	0
Investment Income	329	343	358
Increase in Value of Investments	553	572	591
Net Return from Investments	882	915	948
	0	0	0
<u>Net Change in Fund</u>	<u>781</u>	<u>801</u>	<u>840</u>

6. RECOMMENDATIONS

6.1 As stated at the front of the report.

APPENDIX 1

GMPF Management Expenditure 2017/18 Budget Proposal

	(1)	(2)	(3)
	Original	Changes	Proposal
	Estimate		Estimate
	2016/17		2017/18
<u>Type of Expenditure</u>			
	£'000	£'000	£'000
Staff Costs			
Staffing Costs	5,702	612	6,314
Training and Insurance	106	(7)	99
Total	5,808	605	6,413
Direct Costs			
Publications and Subscriptions	70	32	102
Travel and Subsistence	100	5	105
Premises	817	293	1,110
Postage, Printing, Telephone	244	(40)	204
Office Equipment and Software	844	(27)	817
Investment Advisory Expenses	50	16	66
Bank Charges and Custodian Fees	386	28	414
Managers and Professional Fees	19,506	779	20,285
Performance Measurement Services	101	26	127
Communications	255	30	285
	22,373	1,142	23,515
Central Establishment Charges	379	16	395
Less:			
Recovery of Management and Legal Fees	(351)	(345)	(696)
Admin Fees	(20)	0	(20)
Commission Recapture	(100)	0	(100)
Total	28,089	1,418	29,507