

Agenda Item No 6(e)

DERBYSHIRE COUNTY COUNCIL

CABINET

16 March 2020

Report of the Director of Finance & ICT

ADVANCED PAYMENT OF PENSION CONTRIBUTIONS PROPOSAL
(STRATEGIC LEADERSHIP, CULTURE AND TOURISM)

1 Purpose of the Report

To seek approval for the Council to make a lump sum payment on 30 April 2020, to the Derbyshire Pension Fund, of its Local Government Pension Scheme employer contributions, in full, for the period 1 April 2020 to 31 March 2023.

2 Information and Analysis

Background

The Council is required to make £65.333m of savings over the period 2020-21 to 2024-25. To ease the profile over which these savings have to be achieved and to contribute to the cost of one-off pressures it is proposed to achieve one-off savings in the period 2020-21 to 2022-23 by paying all of the Council's employer contributions to the Derbyshire Pension Fund ("the Fund") in advance, on 30 April 2020. A number of other local authorities have made similar arrangements with their pension providers in recent years.

The Council commissioned Hymans Robertson LLP, in its capacity as Fund Actuary, to prepare a report to include an estimate of the lump sum payment that would be required to pay its contributions in advance. This report was received on 17 January 2020.

Prior to any prepayments, the Council's certified contribution rate payable will be 15.5% of the cost of payroll, plus an additional monetary element of £15.536m. In 2018-19 the Council's payroll was £254.496m.

In preparing its estimate, the Actuary has made the following assumptions:

- The cost of payroll will increase by 3% each year over the period to 31 March 2023.
- The Fund is likely to earn investment returns of 3.6% each year.
- The lump sum prepayment would be made during March 2020 (i.e. 0.5, 1.5 and 2.5 years earlier on average than had contributions been paid

by monthly instalments for financial years 2020-21, 2021-22 and 2022-23). The Actuary has confirmed that its calculations apply if the payment date is within three months of March 2020 and in practice the Council would make the payment at the end of April 2020.

On this basis, it is estimated that the total cost of employer pension contributions between 1 April 2020 and 31 March 2023 would be £175.959m and this could be reduced to £166.852m if the Council were to make a lump sum payment in April 2020 of all its contributions due for the three year period to 31 March 2023. The Council's average all-in contribution rate for the period would reduce from 21.08% to 19.99% of pensionable pay.

Proposal

Allowing for the saving on the contributions it would otherwise have had to pay each month, the Council proposes to adopt a borrowing strategy that aims to have a neutral impact on the Council's cash position, enabling it to maintain a resilient level of working capital to meet day to day expenditure. In order to do this, it is proposed to borrow £56.000m from other local authority lenders at a fixed interest rate for 1 year and £55.000m from the Public Works Loans Board (PWLB) for a period of 2 years (although it may be possible to find a cheaper short term funding source for the two year borrowing) to fund the Council's capital programme. At 31 March 2020 the Council's Capital Financing Requirement (CFR) is forecast to be £489.236m, comprised of £277.474m from external borrowing and £211.762m from internal sources, therefore a switch between external and internal borrowing of £111.000m will maintain external borrowing below the underlying level. The balance of funds required to make the lump sum prepayment will be met from internal sources.

As at 10 January 2020, the Council could borrow from the PWLB, for 2 years, at a rate of interest of 2.38% and from other local authorities at an average rate of 1.1%.

There would be an opportunity cost of the use of cash balances as a result of interest income foregone. If the balances were available to invest, it is anticipated that the Council could earn interest at an average rate of 1%.

Assuming interest rates remain unchanged from those at 10 January 2020, it is forecast that cash savings of around £5.199m should be achievable over the three year period.

	£m
Estimated Contributions due for 2020-21 to 2022-23 (based on the total certified rate)	175.959
LESS: Lump Sum prepayment	-166.852
Cash Saving before Finance Costs	9.107
<u>LESS: Interest Costs</u>	
Loan from PWLB (£55m, 2yrs, 2.38%)	-2.618
Loans from Other Local Authorities (£56m, 1yrs, 1.1%)	-0.616
Investment interest foregone	-0.674
Cash Saving	5.199

Expected Profile of Savings

Based on the actuarial assumptions and funding strategy outlined in the above proposal, it is anticipated that one-off savings can be achieved of £0.772m in 2020-21, £1.496m in 2021-22 and £2.931m in 2022-23.

These forecast savings are comprised of the following elements impacting on the Council's budgets:

	2020-21 £m	2021-22 £m	2022-23 £m	TOTAL £m
Average 21.08% all-in contribution rate	56.916	58.624	60.383	175.923
Average 19.99% all-in contribution rate	-53.970	-55.589	-57.257	-166.816
Reduction in Cost to Budgets of Pension Contributions	2.946	3.035	3.126	9.107
Interest Payable on Additional Borrowing	-1.925	-1.309	0.000	-3.234
Reduction in Interest Receivable on Internal Balances	-0.249	-0.230	-0.195	-0.674
Saving / (Cost)	0.772	1.496	2.931	5.199

This profile of costs and savings reflects the additional borrowing and consequently the higher interest costs which have to be incurred in the earlier years.

The impacts of the proposal on the Council's cash flows are detailed in Appendix 1.

Sensitivity

The scale of the financial benefits of the proposal is influenced by the following three variables:

- The interest rate the Council could earn on its available balances.
- The rate of growth in the cost of the Council's pensionable payroll.
- The average return that the Fund can achieve on its investments.

The effects of these variables changing from the values assumed by the Actuary is considered in Appendix 2. This sensitivity analysis examines the effect of changing just one of the variables at a time.

The returns the Council can earn on its available balances is closely correlated to base rate. A higher interest rate increases the cost to the Council of tying up funds, on which it could otherwise earn a return. Arlingclose, the Council's Treasury Management Advisors, forecast that the current base rate of interest of 0.75% is unlikely to change significantly over the next three years; however, this is likely to be dependent on the nature of the United Kingdom's exit from the European Union and its future trading relationship. Changes to base rate of -0.25% to +0.75% per year are expected to alter the anticipated savings by +£0.155m to -£0.465m over the period.

The rate of payroll growth influences the contributions the Council is required to pay to the Fund. A higher than anticipated rate of payroll growth requires higher than expected contributions. The model assumes that the lump sum prepayment of £166.852m is fixed and that any difference resulting from a higher or lower actual payroll than expected would act to increase or reduce the Council's net pension liability. A higher liability would require greater contributions to be made in future years or top-up payments could be made to mitigate this outcome if desired. If payroll growth only averaged 2% each year, the expected savings from the proposal fall by £1.448m, however the net pension liability would also reduce by £3.529m. If payroll growth averaged 4.0% however, the expected savings would increase by £9.033m and the net pension liability would increase by £3.606m.

The average returns the Fund achieves on its investments over the three year period does not affect the expected savings from the proposal. However, if returns are higher or lower than anticipated then this will act to reduce or increase the Council's net pension liability. If investment returns averaged 7% each year then the pension liability would reduce by £7.787m, or if average returns dropped to 1.5% each year the pension liability would increase by £5.197m.

Assigning probabilities to these different possible outcomes, based on a judgement of current trends and economic conditions, allows an expectation of the likely effect of these factors to be derived. On this basis it is anticipated that, by the end of the three year period, the savings are likely to be £0.684m lower and the Council's net pension liability £0.627m lower than the model suggests.

Risks and Considerations

Whilst it is anticipated that the proposal will be financially advantageous to the Council, the following factors and implications should be considered:

- The same eventual benefits will need to be paid by the Fund regardless of how much and when employer contributions are paid.
- The proposal assumes that the Fund can obtain positive investment returns. If average returns for the period were to fall lower than 1.5% each year, then the cost of borrowing would outweigh the returns and it would have proved beneficial to pay the contributions throughout the period as they became due, rather than in advance.
- The Actuary has assumed that the Fund can generate average returns of 3.6% each year. Higher or lower actual returns will deliver greater or reduced financial benefits.
- The Fund will have to accommodate the advanced contribution in its cash profile and allow for a reduction in its regular contributions over the period.
- The proposal utilises up to £52.000m of the Council's working capital. Whilst this reduces the balance available to the Council to manage its day-to-day cash flows from a Treasury Management perspective it no way constrains the council's ability to meet its commitments and react to unforeseen events over the three years of the initiative. The reduction in interest that can be generated as a result of lower cash balances has been accounted for in the business case.
- The Council's usual arrangement of making contributions at regular monthly intervals allows the Fund to ride out fluctuations in market returns. Paying a lump sum contribution concentrates the risks and rewards. If the investment proves to have been made at a high point in the market the benefits would be diluted and conversely if it had been made at a low point this would deliver greater benefits.
- The Council and the Fund's Auditor will need to be satisfied with the arrangements for recording and reporting the advanced contribution.
- A mechanism will be required to check whether actual payroll amounts fall above or below the assumed level when calculating the prepayment. If actual payroll does not fall within the Actuary's expectations, the Fund may receive insufficient or excessive contributions. The Actuary would be able to calculate any shortfall or excess based on the Council's up-to-date payroll figure at the end of each financial year. Any shortfall would require a top-up payment and any excess could either be refunded to the Council or retained by the Fund and used to reduce the employer's deficit.

3 Financial Considerations

As set out above.

4 Other Considerations

In preparing this report the relevance of the following factors has been considered: legal, prevention of crime and disorder, equality and diversity, human resources, environmental, health, property, transport and social value considerations.

5 Background Papers

Papers held in Technical Section, Finance & ICT, Room 137, County Hall.

6 Key Decision

Yes.

7 Is it necessary to waive the call-in period?

No.

8 Officer's Recommendation

That Cabinet:

8.1 Approves a lump sum payment to be made on 30 April 2020 to the Derbyshire Pension Fund for the Council's employer contributions, in full, for the period 1 April 2020 to 31 March 2023.

PETER HANDFORD

Director of Finance & ICT

Appendix 1

Public

Cash Flow Forecast

Month Ending	Lump Sum Prepayment £	PWLB Borrowing £	Local Authority Borrowing £	Reduction in Employer Contributions Payable £	Interest Payable on PWLB Borrowing £	Interest Payable on Local Authority Borrowing £	Reduction in Interest Received on Balances £	Net Cash (Out)/In Flow for Month £	Cumulative Cash (Out)/In Flow £
30/04/2020	-166,852,270.00	55,000,000.00	56,000,000.00	4,782,099.58				-51,070,170.42	-51,070,170.42
31/05/2020				4,782,099.58			-42,558.48	4,739,541.11	-46,330,629.31
30/06/2020				4,782,099.58			-38,573.39	4,743,526.19	-41,587,103.12
31/07/2020				4,782,099.58			-34,588.31	4,747,511.27	-36,839,591.85
31/08/2020				4,782,099.58			-30,603.23	4,751,496.36	-32,088,095.49
30/09/2020				4,782,099.58			-26,618.14	4,755,481.44	-27,332,614.05
31/10/2020				4,782,099.58			-22,633.06	4,759,466.52	-22,573,147.53
30/11/2020				4,782,099.58			-18,647.98	4,763,451.61	-17,809,695.92
31/12/2020				4,782,099.58			-14,662.89	4,767,436.69	-13,042,259.24
31/01/2021				4,782,099.58			-10,677.81	4,771,421.77	-8,270,837.46
28/02/2021				4,782,099.58			-6,692.73	4,775,406.85	-3,495,430.61
31/03/2021				4,782,099.58			-2,707.65	4,779,391.94	1,283,961.33
30/04/2021			-56,000,000.00	4,886,722.57	-1,309,000.00	-616,000.00	0.00	-53,038,277.43	-51,754,316.10
31/05/2021				4,886,722.57			-41,316.96	4,845,405.61	-46,908,910.49
30/06/2021				4,886,722.57			-37,244.69	4,849,477.88	-42,059,432.61
31/07/2021				4,886,722.57			-33,172.42	4,853,550.15	-37,205,882.47
31/08/2021				4,886,722.57			-29,100.15	4,857,622.42	-32,348,260.05
30/09/2021				4,886,722.57			-25,027.89	4,861,694.69	-27,486,565.37
31/10/2021				4,886,722.57			-20,955.62	4,865,766.95	-22,620,798.41
30/11/2021				4,886,722.57			-16,883.35	4,869,839.22	-17,750,959.19
31/12/2021				4,886,722.57			-12,811.08	4,873,911.49	-12,877,047.70
31/01/2022				4,886,722.57			-8,738.81	4,877,983.76	-7,999,063.94
28/02/2022				4,886,722.57			-4,666.54	4,882,056.03	-3,117,007.91
31/03/2022				4,886,722.57			-594.27	4,886,128.30	1,769,120.39
30/04/2022		-55,000,000.00		4,994,484.25	-1,309,000.00		0.00	-51,314,515.75	-49,545,395.36
31/05/2022				4,994,484.25			-38,193.27	4,956,290.98	-44,589,104.38
30/06/2022				4,994,484.25			-34,031.20	4,960,453.05	-39,628,651.33

Appendix 1

Public

Month Ending	Lump Sum Prepayment £	PWLB Borrowing £	Local Authority Borrowing £	Reduction in Employer Contributions Payable £	Interest Payable on PWLB Borrowing £	Interest Payable on Local Authority Borrowing £	Reduction in Interest Received on Balances £	Net Cash (Out)/In Flow for Month £	Cumulative Cash (Out)/In Flow £
31/07/2022				4,994,484.25			-29,869.13	4,964,615.12	-34,664,036.21
31/08/2022				4,994,484.25			-25,707.06	4,968,777.19	-29,695,259.02
30/09/2022				4,994,484.25			-21,544.99	4,972,939.26	-24,722,319.76
31/10/2022				4,994,484.25			-17,382.92	4,977,101.33	-19,745,218.43
30/11/2022				4,994,484.25			-13,220.85	4,981,263.40	-14,763,955.02
31/12/2022				4,994,484.25			-9,058.78	4,985,425.47	-9,778,529.55
31/01/2023				4,994,484.25			-4,896.70	4,989,587.54	-4,788,942.01
28/02/2023				4,994,484.25			-734.63	4,993,749.61	204,807.60
31/03/2023				4,994,484.25			0.00	4,994,484.25	5,199,291.85
TOTAL	-166,852,270.00	0.00	0.00	175,959,676.80	-2,618,000.00	-616,000.00	-674,114.95	5,199,291.85	

