

# Pensions Committee

2.00pm, Wednesday, 26 June 2019

## Annual Investment Update – Scottish Homes Pension Fund

Item number	5.6
Executive/routine	
Wards	All
Council Commitments	<a href="#">Delivering a Council that works for all</a>

### 1. Recommendations

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The Pensions Committee (**Committee**) is requested to:

1.1 **note** the report.

**Stephen S. Moir**

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## Annual Investment Update – Scottish Homes Pension Fund

### 2. Executive Summary

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- 2.1 This report provides an update for the year to end March 2019 on the strategic allocation and the invested assets of the Scottish Homes Pension Fund.

### 3. Background

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- 3.1 The City of Edinburgh Council took over the administration of the deferred and pensioner liabilities of Scottish Homes (**Fund**) in July 2005. An agreement between the Scottish Government and the City of Edinburgh Council (the **Guarantee**) was put in place in June 2005 whereby the Scottish Government acts as the ‘Guarantor’ for the Fund liabilities.
- 3.2 The Guarantee and the investment strategy are designed to reduce investment risk as the Fund is closed to new members and the liabilities are maturing over time.
- 3.3 The strategy, approved by the Pensions Committee in December 2014, changed the allocation to equities, bonds and property dependent on the development of the actuary’s estimate of the funding level. The strategy anticipated that the equity and property allocations would reduce over time as the funding level increases to 100% by 2044.
- 3.4 The Target Funding Level (**TFL**), as set out in the Guarantee, was 93% at 31 March 2017, the date of the last formal actuarial valuation. The Actual Funding Level (**AFL**) was 104.7%, which prompted a change to the Fund’s investment strategy allocation – the remaining equity and property allocations were reduced to zero and the bond allocation rose to 100%.
- 3.5 As the AFL was above the TFL, no deficit contributions are required from the Scottish Government (as Guarantor) for the period April 2018 to March 2021. The Guarantor is, however, responsible for meeting the cost of investment expenses and the cost of administration expenses, which will be met out of the current funding surplus.

## 4. Main report

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### Funding Level

- 4.1 At end March 2017, the Fund's actuary estimated that the actual funding level was 104.7%, and so the Fund was fully funded. This was partly because the actuary made some revisions to the financial and demographic assumptions to reflect actual experience over the intervening years.
- 4.2 As full funding had been achieved faster than expected, the Scottish Government was consulted over future funding options. It decided not to change the Funding Agreement, and so the investment strategy to minimise investment risk was retained.
- 4.3 At end March 2019, the funding level is estimated to be 105.4%.

### Investment Objective

- 4.4 Given that the Fund had achieved full funding, the Committee approved a new investment objective in June 2018:

*To match the cash flow from gilt income and redemption payments as closely as possible with the expected liability payments of the Fund.*

### Investment Strategy Allocation

- 4.5 Achievement of full funding meant that the Fund no longer needed to take investment risk by investing in equities and property. Consequently, the strategic allocation to bonds (UK gilts) was increased to 100%. The table below shows the Fund strategy from March 2017 to March 2019.

<b>Scottish Homes Pension Fund Evolution of Strategy 2017-19</b>			
<b>Asset Class</b>	<b>Strategy Allocation March 2017</b>	<b>Strategy Allocation March 2018</b>	<b>Strategy Allocation March 2019</b>
Gilts	77.5%	100%	100%
Equities	17.5%	0%	0%
Property	5%	0%	0%
<b>TOTAL</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

### Actual Allocation

- 4.6 As reported last year, the Fund proceeded to divest its remaining equity and property assets, in line with the Funding Agreement, to reduce investment risk. Shortly after the end of March 2018, the final sale of property assets was completed, leaving the Fund entirely invested in index-linked gilts and cash. The index linked gilts were structured to broadly match the expected liability payments as they fall due.
- 4.7 A detailed analysis of the Fund's liabilities has been undertaken during 2018/19 to ensure that the invested assets are as closely matched with the liability profile as

possible, taking into consideration the expected duration of liabilities and whether they are fixed or index-linked in nature.

- 4.8 Implementation of the strategy was completed in early 2019 with a portion of index-linked assets being sold and reinvested in nominal gilts to achieve a closer asset-liability match.
- 4.9 At end March 2019, the Fund has 'cash flow matched' liabilities up to one year beyond the next actuarial valuation expected at 31 March 2020, and 'duration matched' liabilities beyond that. This is because there is greater certainty in the earlier period - funding levels will continue to be subject to the actuary's financial or demographic assumptions for future experience, which will be reassessed during 2020/21.
- 4.10 The table below shows the Fund's actual allocations to each asset class from 31 March 2017 to 31 March 2019.

<b>Scottish Homes Pension Fund</b>			
<b>Actual Allocation 2018-19</b>			
<b>Asset Class</b>	<b>Actual Allocation March 2017</b>	<b>Actual Allocation March 2018</b>	<b>Actual Allocation March 2019</b>
Index-Linked Gilts	76.4%	91.9%	63.6%
Nominal Gilts	0.0%	0.0%	34.2%
Equities	17.2%	0.1%	0.0%
Property	4.8%	2.7%	0.0%
Cash	1.6%	5.4%	2.2%
<b>TOTAL</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Asset Value £m</b>	<b>169</b>	<b>162</b>	<b>163</b>

- 4.11 At end March 2019, the funding level is estimated to be 105.4%. The Fund's assets have increased in value by 4.6% adjusted for cash flow movements to pay pensions, while a proxy of the value of liabilities has increased by 4.4%.
- 4.12 As the Fund is mature, it must sell assets to pay pensions. Cash or cash equivalents are held to enable pensions to be paid in between the dates that gilts redeem. Over 2018/19, £6.6m was sold to pay pensions, which compares with the Fund value of £163m at the end of March 2019.

## **5. Next Steps**

- 5.1 The funding level of the Fund will continue to be monitored ahead of the 2020 Actuarial Valuation, and gilts will be sold as required to pay pensions.

## **6. Financial impact**

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- 6.1 This report provides the funding level of the Fund, which potentially impacts the contributions required from the Scottish Government.
- 6.2 The financial impact for the Scottish Government is a key consideration. The decision not to change the funding agreement provides greater certainty of the funding level, but at a potentially higher long-term cost.

## **7. Stakeholder/Community Impact**

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- 7.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds and they are invited to comment on the relevant matters at Committee meetings.
- 7.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report.
- 7.3 There are no adverse sustainability impacts arising from this report.

## **8. Background reading/external references**

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- 8.1 None.

## **9. Appendices**

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- 9.1 None.