Pensions Committee

2.00pm, Wednesday, 24 June 2020

Annual Investment Update – Scottish Homes Pension Fund

Item number 5.13

1. Recommendations

The Pensions Committee (Committee) is requested to:

1.1 note the report.

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Annual Investment Update – Scottish Homes Pension Fund

2. Executive Summary

2.1 This report provides an update for the year to end March 2020 on the strategic allocation and the invested assets of the Scottish Homes Pension Fund (the Fund).

3. Background

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 increased 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) at that date 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

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 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 2020, the funding level is estimated to be broadly similar to the position at the end March 2017 valuation. The formal triennial valuation is due to be carried out in the coming year, which will provide an updated funding level incorporating realised experience since the previous valuation and any changes to the actuary's financial and demographic assumptions.

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 to grow assets more than liabilities by investing in equities and property. Consequently, the strategic allocation to bonds (UK gilts) was increased to 100%. The table below shows that there has been no change to Fund strategy over the last three years.

Investment Strategy (2017-2020)				
Asset Class	**31 March 2017**	**31 March 2018**	**31 March 2019**	**31 March 2020**
Gilts	77.5%	100%	100%	100%
Equities	17.5%	0%	0%	0%
Property	5.0%	0%	0%	0%
TOTAL	**100%**	**100%**	**100%**	**100%**

Actual Allocation

4.6 As reported last year, a detailed analysis of the Fund's liabilities was 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. This resulted in an increase in holdings of nominal gilts and a decrease in index-linked gilts to achieve a closer asset-liability match.

4.7 The Fund has 'cash flow matched' liabilities up to one year beyond the next actuarial valuation and 'duration matched' liabilities beyond that. This is because there is greater certainty in the earlier period - funding levels will continue to be affected by changes to the actuary's financial or demographic assumptions for future experience at the time of the triennial actuarial valuations. These are currently being reassessed based on the experience of the last three years as part of the process to determine the actuarial valuation at 31 March 2020.

4.8 The table below shows the Fund's actual allocations to each asset class from 31 March 2017 to 31 March 2020.

	Actual Allocation (2017- 2020)			
Asset Class	**31 March 2017**	**31 March 2018**	**31 March 2019**	**31 March 2020**
Gilts	76.4%	91.9%	97.8%	99.2%
Index-Linked Gilts	*76.4%*	*91.9%*	*63.6%*	*63.6%*
Nominal Gilts	*0.0%*	*0.0%*	*34.2%*	*35.6%*
Equities	17.2%	0.1%	0.0%	0.0%
Property	4.8%	2.7%	0.0%	0.0%
Cash	1.6%	5.4%	2.2%	0.8%
TOTAL	**100%**	**100%**	**100%**	**100%**
Asset Value (£)	**£169m**	**£162m**	**£163m**	**£163m**

4.9 At end March 2020, the funding level is estimated to be broadly similar to the position at the end March 2017 valuation. The formal triennial valuation is due to be carried out in the coming year, which will provide an updated funding level incorporating realised experience since the previous valuation and any changes to the actuary's financial and demographic assumptions.

4.10 As the Fund is mature, it must redeem maturing assets to pay pensions. Cash or cash equivalents are held to enable pensions to be paid in between the dates that gilts redeem. Over 2019/20, £6.7m was redeemed to pay pensions, which compares with the Fund value of £163m at the end of March 2020.

Transfer of employer - Homeless Action Scotland

4.11 Following retrospective termination of Homeless Action Scotland ("HAS") from Lothian Pension Fund ("Lothian") (effective 12 July 2018), on 31 March 2020, Scottish Ministers issued a direction to the effect that the Fund be substituted as the appropriate fund for HAS as at 11 July 2018, and that all assets and liabilities relating to HAS be transferred from Lothian to the Fund.

4.12 The Lothian actuary calculated the liabilities that remained on cessation at £641,000.

4.13 The process for transferring the assets and liabilities is underway and will be completed (at Scottish Ministers' direction) by 30 June 2020.

5. Financial impact

5.1 This report provides the funding level of the Fund, which potentially impacts the contributions required from the Scottish Government.

5.2 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.

6. Stakeholder/Regulatory Impact

6.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the fund and they are invited to comment on the relevant matters at Committee meetings.

6.2 There are no adverse governance, compliance or regulatory implications as a result of this report.

7. Background reading/external references

7.1 None.

8. Appendices

None.