



Pensions Committee

2.00pm, Wednesday, 21 June 2023

Annual Investment Update – Scottish Homes Pension Fund

Item number 6.8

1. Recommendations

The Pensions Committee (Committee) is requested to:

- 1.1 note the asset allocation, investment performance and funding update of the Scottish Homes Pension Fund.

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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 2023 on the strategic allocation and the invested assets of the Scottish Homes Pension Fund (the Fund).
- 2.2 The actuarial funding level of the Scottish Homes Pension Fund on 31 March 2020 was 118%. The Fund's actuary, Hymans Robertson, reported the same funding level of 118% in their funding update dated 31 March 2022, and in their recent 2022/2023 Actuarial Statement (dated May 2023) have stated that the funding level at end March 2023 is "likely to be fairly similar to that reported at the previous formal valuation."
- 2.3 The triennial actuarial valuation is currently underway, following which the formal valuation result at 31 March 2023 will be confirmed, which will include any changes reflecting fund experience and financial and demographic assumptions.
- 2.4 In line with the Scottish Government's guidance, the Fund's objective is to minimise the investment shortfall risk of assets relative to liabilities. Accordingly, the Fund's assets comprise UK gilts and cash as closely matched to the estimated liability payments as possible.

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 Target Funding Level (TFL), as set out in the Guarantee, was 94.5% on 31 March 2020 rising to 100% in 2044. The Actual Funding Level (AFL) on 31 March 2020 was 118%.
- 3.4 As the AFL was above the TFL, no deficit contributions are required from the Scottish Government (as Guarantor) for the period April 2021 to March 2024. The Guarantor is, however, responsible for meeting the cost of administration and oversight and

governance, and these have been set at £90,000 per annum. Any investment expenses will be met from the current funding surplus.

4. Main Report

Funding Level

- 4.1 As reported at the March 2021 Pensions Committee meeting, the funding level of the Scottish Homes Pension Fund at end March 2020 was 117.7%, an increase from 104.7% at the 2017 valuation. The increase in funding level reflected actuarial revisions to financial and demographic assumptions based on actual experience over the three years as well as changes to asset values, which are not a perfect match for liability values.
- 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 is retained.

Investment Objective

- 4.3 Given achievement of full funding, the Committee reaffirmed the following investment objective in June 2021:
- *To match the cash flow from gilt income and redemption payments as closely as possible with the expected liability payments of the Fund.*
- 4.4 This is reflected in the Statement of Investment Principles.

Investment Strategy

- 4.5 The investment strategy to minimise risk means that the Fund only invests in bonds (UK gilts, UK T-bills, and cash), which provide certainty of cash flows.
- 4.6 An analysis of the Fund's liabilities shows that some of them are fixed in nature and some index linked. To achieve as close a match as possible with liabilities, the Fund invests in both nominal and index-linked gilts. The actual asset allocations at 31 March 2022 and 31 March 2023 are shown in table 1 below.

Table 1

Policy Group	Actual Allocation	
	31 March 2022	31 March 2023
Gilts	91.9%	84.6%
<i>Index-Linked Gilts</i>	64.6%	59.1%
<i>Nominal Gilts</i>	27.3%	25.5%
Cash	8.1%	15.4%
TOTAL	100%	100%
Asset Value (£)	£154m	£125m

- 4.7 The value of the assets fell over 2022/23, due to higher discount rates as the BOE raised base rates significantly over the period to address high inflation. The fall in the value of the assets is estimated to have been matched by the fall in the value of the liabilities.
- 4.8 At end March 2023, the Fund's assets are matched with the duration of the liabilities. The Fund's strategy is to match the cash flows of liabilities one year beyond the date of the next valuation and to match the duration of liabilities beyond that. This is because of the greater visibility of pension payments in the near term. Over the longer term, funding levels are subject to the actuary's financial and demographic assumptions of future experience, which are re-examined every three years.
- 4.9 Hymans Robertson, the Fund's actuary, have stated that the funding level at end March 2023 (the next triennial valuation) is "likely to be fairly similar to that reported at the previous formal valuation".
- 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 2022/23, £7.2m was redeemed to pay pensions, which compares with the Fund value of £125m at the end of March 2023.
- 4.11 Being fully funded, the fund invests excess cash in short-dated bills and gilts. Cash increased over 2022/23, as the fund holds more short-dated paper than it needs for cash outgoings and a number of these redeemed over the period. The cash and cash equivalents balance at end March 2023 covers expected pension payments for approximately thirty-two months. Following the confirmation of the March 2023 valuation results, the cash position will be reviewed in order to cover expected outflows to March 2027.

5. Financial impact

- 5.1 The financial impact for the Scottish Government is described in paragraph 3.4. The funding level of the Scottish Homes Pension Fund, which depends on relative changes to asset and liability values, affects the contributions required from the Scottish Government. Lothian Pension Fund recovers expenses for administering and managing the Fund.
- 5.2 The Scottish Government's 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.