



Pensions Committee

2.00pm, Wednesday, 26 June 2024

Annual Investment Update – Scottish Homes Pension Fund

Item number 6.11

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.

Emmanuel Bocquet

Chief Investment Officer, Lothian Pension Fund

Contact: Ross Crawford, Portfolio Manager, Lothian Pension Fund

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1900

Annual Investment Update – Scottish Homes Pension Fund

2. Executive Summary

- 2.1 This report provides an update for the year to end March 2024 on the strategic allocation and the invested assets of the Scottish Homes Pension Fund (the Fund).
- 2.2 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.
- 2.3 Over the 12 months to 31 March 2024 the Fund returned -0.04% as higher yields were offset by income received.
- 2.4 The actuarial funding level of the Fund on 31 March 2023 was 127%, an improvement from the previous funding level of 118% on 31 March 2020.
- 2.5 The next triennial actuarial valuation is scheduled for 31 March 2026 and will include any changes reflecting fund experience and financial and demographic assumptions.

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's 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 95.5% on 31 March 2023, rising to 100% in 2044. The Actual Funding Level (AFL) on 31 March 2023 was 127%.
- 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 2024 Committee meeting, the funding level of the Fund at end March 2023 was 127.3%, an increase from 117.7% at the 2020 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 assets (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 inflation 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 2023 and 31 March 2024 are shown in table 1 below.

Table 1

Policy Group	Actual Allocation	
	31 March 2023	31 March 2024
Gilts	84.6%	92.3%
Index-Linked Gilts	59.1%	61.2%
Nominal Gilts	25.5%	31.1%
Cash	15.4%	7.7%
TOTAL	100%	100%
Asset Value (£)	£125m	£118m

- 4.7 The value of the assets fell over 2023/24, due to higher discount rates as the BOE continued raising base rates 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 2024, the Fund's assets are matched with the duration of the

liabilities. The Fund's strategy is to match the liability cash flows 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 As the Fund is mature, it may need to redeem assets to pay pensions. Cash or cash equivalents are held to enable pensions to be paid in between the dates that gilts mature. Over 2023/24, £7.2m was redeemed to pay pensions, which compares with the Fund value of £118m at the end of March 2024.
- 4.10 Being fully funded, the fund invests excess cash in short-dated bills and gilts. The fund holds more cash and cash equivalents than it needs for cash outgoings as it is in funding surplus. The cash and cash equivalents balance at end March 2024 covers expected pension payments for approximately fifteen months. With the March 2023 valuation results now published, the cash position will be reviewed to cover expected outflows to March 2027 as part of any rebalancing activity required.

5. Financial impact

- 5.1 The financial impact for the Scottish Government is described in paragraph 3.4. The funding level of the 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.