DARTMOOR NATIONAL PARK AUTHORITY

3 February 2017

LOCAL GOVERNMENT PENSION SCHEME
ACTUARIAL VALUATION RESULTS

Report of the Head of Business Support

Recommendation: **That a one-off payment of £500,000 is made, from Reserves, to the Devon Pension Fund in February 2017 to reduce the impact of the Past Service Deficit recovery and future Employer Pension Contribution Rate rises**

1 Background

1.1 Employees of the Authority are members of the Local Government Pension Scheme (LGPS) administered by Devon County Council (DCC). The scheme provides defined benefits to members (retirement lump sums and pensions) related to pay and service.

1.2 The LGPS has seen many changes in the past fifteen years, one of the most significant being that from 1 April 2014, the LGPS changed from a Final Salary Pension Scheme to a Career Average Revalued Earnings (CARE) Pension Scheme. This means that the benefits a member builds up are now worked out using their pay each scheme year, rather than on their final salary and provides benefits based on career average revalued salary and length of service. However, everything a member has paid into their pension before 1 April 2014 is protected and based on final salary.

1.3 Employees make payments each month from their salary into the Fund, based on a percentage of their annual salary, as set out in legislation. As part of the terms and conditions of employment, the Authority also makes contributions to the Fund and the amount it pays is determined by the Fund's Actuary (an independent person). Contributions are reviewed every three years as a result of the actuarial valuation of the Fund. The contributions that the Authority and its employees pay into the Fund are calculated at a level to balance the pension liabilities with investment assets. The aim being that the Authority's pension fund (within the whole Devon Fund) is 100% funded.

2 The Triennial Funding Valuation

2.1 Employer Contributions are set every three years as a result of a Triennial Valuation of the Fund as required by Regulations. The Triennial Valuation answers the question *"How much do employers need to pay in the future, to have enough assets to pay benefits?"* The Actuary in accordance with the regulations must:

- *Certify* the levels of employer contributions to secure the *solvency* of the Fund and the *long term cost efficiency of the Scheme.*

- Have regard to the Funding Strategy Statement as determined by the Administrating Authority (DCC)
- Have regard to the desirability of maintaining as nearly constant a (primary) contribution rate as possible (consideration of spreading and stepping)
- Consider the different approaches possible for different employer types

3 The 2016 Triennial Valuation Results

3.1 The triennial actuarial valuation examines how the assumptions built into the previous valuation have fared and then considers future prospects for the Fund. The Actuary has to certify levels of contribution to secure the solvency of the Devon Fund, but also have regard to the desirability of maintaining as stable a contribution rate as possible.

3.2 The Actuary also has to take into account Section 13 of the Public Sector Pensions Act 2013. This provides for an independent review (by the Government Actuary's Department (GAD)) of the valuation and employer contribution rates to check that they are appropriate and requires remedial action to be taken where that review identifies a problem. The Actuary will therefore aim to ensure that the assumptions applied will lead to contribution rates that ensure the long term cost efficiency of the fund and achieve solvency over an appropriate period, and thus avoid any red flags when GAD carry out their review. Long term cost efficiency is now seen as a requirement while stability of contribution rates is only "desirable".

3.3 The following factors, outlined in paragraphs 3.4 to 3.6, have been considered by the Actuary and have been taken into account in the current valuation, and calculation of the level of deficit and future contribution levels.

3.4 ***Inter-valuation experience*** – The valuation will be impacted by what has happened over the three years since the last valuation, compared to the assumptions made by the actuary at the time. These are summarised in the following table:

	Expected	**Actual**	**Effect on Funding Level**
Investment Returns	6.10%	4.80%	Negative
Pay Increases	3.30%	2.20%	Positive
Pension Increases	2.70%	1.30%	Positive
Deaths- Pensions Ceasing	£8,185k	£11,196k	Positive

Investment returns have been below the expected level, which has had a negative impact on the funding level. However, the level of pay and pension increases have both been below the level assumed in 2013, and the value of pension cessations has been higher than anticipated, which will have reduced the Fund's liabilities.

3.5 ***Revised Assumptions*** – These include:

(a) Price Inflation – based on the Bank of England's 20 year inflation curve, average CPI estimated at 2.4% in projecting future liabilities. This compares with an estimate for CPI of 2.7% at the 2013 Valuation.

(b) Salary Increases – Assumed to be equivalent to CPI until 31 March 2020, and CPI + 1.5% thereafter. The level of pay increases takes into account the effect of increments and promotions for individual members of the Fund, not just the national pay awards. This is a lower assumption than that made in 2013.

(c) Statistical Assumptions – The key factor influencing pension liabilities is pensioner mortality, i.e. how long pensioners will be receiving their pension. For this valuation the Actuary has produced an analysis specific to Devon, looking at the mortality experience of the Fund and a socio-economic analysis, based on postcodes and other fields in our member data. This has resulted in an adjustment to 90% of the statistical values in the tables published by the Actuarial Profession's Continuous Mortality Investigation for both males and females. An assumption of a 1.5% long term improvement in life expectancy has been made. This equates to a life expectancy beyond the age of 65 of a further 25.4 years for females and 23.3 years for males retiring now.

(d) Discount Rates – In determining the value of accrued liabilities and future contribution requirements it is necessary to discount future payments to and from the Fund. There are a number of different approaches which can be adopted to derive the discount rate. The Actuary's approach is to reflect the investment return expected to be achieved from the underlying investment strategy. The investment return going forward has been assumed to be 5.5%, which compares with an assumption of 6.1% at the last valuation. This is summarised in the following table:

Asset Class	**Percentage of Fund Assumed**	**Return**	**Real (relative to CPI)**
Gilts	6%	2.4%	0.0%
Other Bonds	8%	3.3%	0.9%
Cash/temporary investments	2%	1.8%	-0.6%
Equities	55%	7.4%	5.0%
Property	14.9%	5.9%	3.5%
Diversified Growth Funds	15%	5.8%	3.4%
Expenses (deduction)		-0.2%	
Neutral estimate of discount rate based on long-term investment strategy		**6.1%**	**3.7%**
Prudence allowance		-0.6%	
Discount rate assumption		**5.5%**	**3.1%**

3.6 ***Deficit recovery period*** – At the last valuation the length of the recovery period was reduced from 30 to 25 years. At this valuation the Actuary has reduced the average recovery period back to 22 years. There is some logic to this, in that the ultimate aim is to reach 100% funding, and as we are three years further on since the last valuation, a reduction of three years in the recovery period demonstrates that the Fund is progressing towards that goal. Reducing the recovery period will decrease the level of risk to the Fund, and reduce the cost of meeting the deficit.

3.7 ***The 2016 valuation results*** for the whole Devon Fund and the Dartmoor National Park element of the Fund is set out below (with a 2013 comparison):

Whole Devon Fund	**2013**	**2016**
Assets	£2,985m	£3,311m
Less Liabilities	£3,588m	£3,939m
Deficit	£603m	£628m
Scheme Funding Position	83%	84%
Future Service Contribution Rate (as a % of pensionable pay)	13.6%	14.9%
Past Service Deficit Rate (as a % of pensionable pay)	5.2%	6.0%
Total Contribution Rate	18.8%	20.9%
Average recovery period	25 years	22 years

Dartmoor National Park Fund	**2013**	**2016**
Assets	£13.5m	£15.6m
Less Liabilities	£15.3m	£17.3m
Deficit	£1.8m	£1.7m
Scheme Funding Position	88%	90%
Future Service Contribution Rate (as a % of pensionable pay)	13.3%	15.2%
Past Service Deficit Rate (as a % of pensionable pay)	5.0%	5.4%
Total Contribution Rate	*18.8%	20.6%
Average recovery period	20 years	17 years

3.8 Members will be aware that the Authority decided to pay an Employer Contribution Rate of *19.7% of pensionable pay whilst we could afford to in order to enhance our deficit recovery strategy. The fact that our Funding level has increased from 88% to 90% demonstrates that the strategy is indeed working.

3.9 As stated in paragraph 2.1 above, the Actuary has to give regard to the desirability of keeping contribution rates as stable as possible. In the past this has been done by varying the length of the deficit recovery period. As a result, the recovery rates for different employers in the Devon Fund vary. The shorter than average deficit recovery period for the Dartmoor National Park Authority reflects our better than average funding level which has enabled the Actuary to shorten the deficit recovery period at past valuations. A shorter deficit recovery period reduces the overall cost of paying off the deficit in the longer term.

4 Options Available to Dartmoor National Park Authority

4.1 The Authority has received notification from DCC regarding the required employer contributions for the period 2017-2020 as set out below (a comparison of the current rate is also shown).

	2014-2017	2017-2020
Future Service contribution rate i.e. the anticipated cost of pension rights members will accrue in the future, expressed as a percentage of pensionable payroll	13.3%	15.2%
Past Service Deficit annual cash contribution i.e. this arises where the cost of pension rights already accrued turn out to be higher than expected (experience vs assumptions made)	£109,000 £113,000 £118,000	£124,103 £127,073 £130,113
Equivalent total % Contribution Rate	18.8%	20.6%

4.2 For the next 3 years, based on the provisional information received the "composite" contribution rate is therefore likely to increase to just under 21% which will add an extra £35k per annum to the salary costs in the 2017-2020 Medium Term Financial Plan compared to the current contribution rate (2016/17).

4.3 The Actuary provided Fund Employers with an opportunity to consider making a one-off cash contribution during 2016/17 which would be then spread across the whole deficit recovery period. This option would still reduce the past service deficit over the next 17 years, but also potentially reduce future pressure on the revenue budget.

4.4 The financial model at Appendix 1 demonstrates the impact on the past service deficit contributions for the periods 2017 to 2034 for two scenarios:

1) Making a £500,000 one-off contribution
2) Making a £750,000 one-off contribution

It can be seen that if we were to make a contribution of £500,000 now, the past service deficit element over the next 3 years could be reduced by circa £35,000 per annum. Furthermore, by 2034 the impact could be a saving of £298,284 against the projected rising cash payments that the model suggests would be required. This is equal to a return on investment of around 7% (at current prices).

Option 1 Summary	£
Current cumulative annual contribution payments forecast 2017-2034	2,800,371
Less Future cumulative annual contribution payments forecast 2017-2034	(2,002,087)
Forecast saving	**798,284**
Less Original Capital payment	(500,000)
Net Saving	**298,284**

Increasing the one-off contribution to £750,000 could reduce the annual contribution payment by just over £53,000 per annum and could result in overall return over 17 years of £447,425 (the same 7% reinvestment return).

Option 2 Summary	**£**
Current cumulative annual contribution payments forecast 2017-2034	2,800,371
Less Future cumulative annual contribution payments forecast 2017-2034	(1,602,946)
Forecast saving	**1,197,425**
Less Original Capital payment	(750,000)
Net Saving	**447,425**

4.5 This also means that our annual total Contribution Rate may be reduced from the proposed 20.6% to 19.0% if we make a £0.5m contribution, or to 18.3% for a £0.75m contribution. It may also allow us to continue with our current strategy of increasing the required contribution rate (over paying) to further enhance our deficit recovery strategy.

4.6 The deficit contributions can be thought of as "paying off" two different things:

- the actual deficit itself and
- the interest that accrues on the deficit each year

The model demonstrates potentially higher savings than we might expect in deficit contributions (when compared to the Discount Rate of around 5.5%) because:

- we would be paying off a part of the deficit upfront rather than spreading it over the whole recovery period and
- the amount of interest being accumulated in each year will be lower

5 Funding the Cash Contribution

5.1 The Authority has maintained a robust level of financial earmarked reserves for many years now, which are continually reviewed and risk assessed see Appendix 3 and the table below:

Earmarked Reserves	**£**
Opening Balance 1 April 2016	**(2,537,831)**
Forecast Spent in year	469,468
New contributions to reserves / carry forwards	(203,787)
Forecast outturn at month 9 (includes Donate for Dartmoor)	(45,351)
Earmarked Reserves forecast closing balance	**(2,317,501)**
General unallocated Reserve	**(450,000)**
Total Reserves Forecast at 31 March 2017	**(2,767,501)**

5.2 The Authority invests its cash balances via a Barclays Bank Treasury Deposit Account. Returns on investment pre 2008 were consistently good; achieving returns of between 3-5%; resulting in a cash return of over £110,000 per annum (£164,000 at the peak in 2007/08). However, after the 2008 “financial crisis” interest rates plummeted and the ability to obtain favorable investment returns became increasingly difficult for public sector bodies. Treasury deposit income has fallen since 2008, to an average of £16,000 in the last 5 years (bank interest rates are below 0.5%). There is currently no indication that interest rates are likely to return to pre-2008 levels in either the short or medium term.

5.3 We have consistently set aside specific earmarked reserves to provide for:

- Pension Fund Past Service Deficit Recovery costs
- Provisions for falling income streams
- Provisions for unforeseen salary related costs (pay settlements are now more certain)
- A Match Funding Reserve to maximise opportunities to lever in external funding
- An “Invest to Save” Reserve to enable us to take advantage of opportunities as they arise

It is therefore proposed to use some of these reserves to make a capital contribution to the Pension Fund by the end of this financial year as follows:

Earmarked Reserves (that could be utilised)	**2016/17 Balance £**	**Pension Fund Payment £**
Pension Fund - Past Service Deficit Recovery	145,000	145,000
Salary Related Provisions	117,000	65,000
Falling Income and price increases provisions	80,000	45,500
Invest to Save	378,233	244,500
Match Funding - unallocated	143,898	0
Total	**864,131**	**500,000**

5.4 Members could of course opt to pay up to £750,000 as set out in the model at Appendix 1 (or something in between). However, any sum above £500,000 could result in the Authority putting itself under undue pressure in the short-medium term, or may result in us being unable to maximise other opportunities that arise during the life of the new Medium Term Financial Plan.

5.5 Indeed the opportunity to invest further cash sums into the Pension Fund can be realised in future financial periods if the Authority so wishes; other neighboring Local Authorities have already done so for the reasons set out in this report.

6 Risk Management

This table presents a summary risk analysis of the making the lump sum cash contribution option.

Risk	Pros	Cons
Economic / Financial	Potentially more favorable investment return achieved that generates savings / reduces contribution rates and cost pressures in future years (when NPG might reduce again) Reduces our Pension Fund deficit and improves the ability to keep contribution rates stable in the future Mitigates the impact of further unfavorable future triennial valuation results (next due in 2020)	The 2016 Valuation only sets rates for the next three years, and figures beyond that are only current forecasts which could change as a result of Fund experience and changes in assumptions. However, contribution rates will still be lower than they would be without the additional payment.
Financial / Operational	Interest rates are at their lowest ever and therefore borrowing rates are more affordable than ever before A high level of reserves have been maintained for a number of years which are not being optimised and could be used to safeguard against future financial pressures that could impact on the delivery of National Park Management Plan (NPMP) outcomes for Dartmoor and its communities	An inability to invest in other projects if Reserves are reduced now i.e. the money can only be spent once. This could mean that the Authority may need to consider Prudential borrowing in the future if the level of reserves is not built back up
Reputational / Environmental	A potential invest to save opportunity that safeguards future resources to deliver NPMP outcomes over the longer-term	The perception that a significant sum of money is being ploughed into staff pensions at the expense of delivering NPMP outcomes

7 Conclusions

7.1 The option available to the Authority to make a one-off capital contribution to the Devon Pension Fund provides an opportunity to make savings and maintain a stable Employer Contribution Rate going forward. Whilst there are risks (see section 6 above) most of which are not in our control, there are also clear benefits i.e. to secure savings, to reduce the deficit, to achieve an improved return on investment and to help stabilise Contribution Rates in the future, which will in return protect Revenue Budgets that should be used to deliver good outcomes for the National Park.

7.2 The advice of Officers is that the Authority can afford to make a lump sum contribution to the Devon Pension fund, without adverse pressure on future cash flow.

DONNA HEALY

Attachments: **Appendix 1 - Pension Fund Model Illustration**
Appendix 2 - Risk Based Analysis of Reserve Balances

Contribution Rates Set per the 2016 Triennial Valuation

Year	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	2032/33	2033/34
Future Service Rate	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%
Cash Deficit Amount Require	£124,103	£127,073	£130,113	£133,226	£138,412	£143,800	£149,397	£155,213	£161,255	£167,532	£174,053	£180,828	£187,867	£195,180	£202,777	£210,671	£218,871
Estimated Total Contributions	£471,226	£482,501	£494,045	£505,865	£525,557	£546,014	£567,268	£589,350	£612,291	£636,125	£660,886	£686,612	£713,339	£741,106	£769,954	£799,925	£831,063
Approx. Total %	20.60%	20.60%	20.60%	20.60%	20.60%	20.60%	20.60%	20.60%	20.60%	20.60%	20.60%	20.60%	20.60%	20.60%	20.60%	20.60%	20.60%

Option 1: Revised Contribution Rates with an additional contribution paid in 2016/17 of £500,000

Year	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	2032/33	2033/34
Future Service Rate	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%
Cash Deficit Amount Require	£88,726	£90,849	£93,023	£95,248	£98,956	£102,808	£106,810	£110,967	£115,287	£119,774	£124,437	£129,280	£134,313	£139,541	£144,973	£150,616	£156,479
Estimated Total Contributions	£435,849	£446,277	£456,954	£467,887	£486,100	£505,022	£524,681	£545,104	£566,323	£588,367	£611,270	£635,064	£659,785	£685,467	£712,150	£739,871	£768,671
Approx. Total %	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%	19.00%
Saving in Year	£35,377	£36,224	£37,090	£37,978	£39,456	£40,992	£42,587	£44,246	£45,968	£47,758	£49,616	£51,548	£53,554	£55,639	£57,804	£60,055	£62,392
Cumulative Saving	**£35,377**	**£71,601**	**£108,691**	**£146,669**	**£186,125**	**£227,117**	**£269,704**	**£313,950**	**£359,918**	**£407,676**	**£457,292**	**£508,840**	**£562,394**	**£618,033**	**£675,837**	**£735,892**	**£798,284**

Option 2: Revised Contribution Rates with an additional contribution paid in 2016/17 of £750,000

Year	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	2032/33	2033/34
Future Service Rate	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%	15.20%
Cash Deficit Amount Require	£71,037	£72,737	£74,477	£76,259	£79,228	£82,312	£85,516	£88,844	£92,303	£95,896	£99,629	£103,507	£107,536	£111,722	£116,071	£120,589	£125,283
Estimated Total Contributions	£418,160	£428,165	£438,409	£448,898	£466,372	£484,526	£503,387	£522,981	£543,339	£564,489	£586,462	£609,290	£633,008	£657,648	£683,247	£709,843	£737,474
Approx. Total %	18.30%	18.30%	18.30%	18.30%	18.30%	18.30%	18.30%	18.30%	18.30%	18.30%	18.30%	18.30%	18.30%	18.30%	18.30%	18.30%	18.30%
Saving in Year	£53,066	£54,336	£55,636	£56,967	£59,184	£61,488	£63,881	£66,369	£68,952	£71,636	£74,424	£77,321	£80,331	£83,458	£86,706	£90,082	£93,588
Cumulative Saving	**£53,066**	**£107,402**	**£163,038**	**£220,005**	**£279,189**	**£340,677**	**£404,558**	**£470,927**	**£539,879**	**£611,515**	**£685,939**	**£763,260**	**£843,591**	**£927,049**	**£1,013,755**	**£1,103,837**	**£1,197,425**

Option 1 Summary	£
Current Annual payments forecast	2,800,371
Future Annual payments forecast	(2,002,087)
Forecast saving	798,284
Less Original Capital payment	(500,000)
Net Saving	298,284

Option 2 Summary	£
Current Annual payments forecast	2,800,371
Future Annual payments forecast	(1,602,946)
Forecast saving	1,197,425
Less Original Capital payment	(750,000)
Net Saving	447,425

Appendix 2 to Report No. NPA/17/006

2016/17 RESERVES: RISK BASED ANALYSIS	Risk Level	Rate	2016/17 Forecast Closing Balance £'000
Grants & Contributions with Restrictions carried forward:			
Grants & Contributions with Restrictions	N/A	Actual	107
Employees:			
Allowance for increased pay awards	Low	1% extra PA	25
Maternity / Paternity Cover	High	Based on 4 staff	42
Equal Pay Claims / Employment Tribunals	Low	Est.	50
Pension Fund - Past Deficit Recovery	Medium	Est.	145
Costs & Awards:			
Appeals / Public Enquiries / Litigation	High	Est.	250
Loss of Income:			
Planning related fees	Medium	10%	19
Reduced Sales, Fees & Charges	Medium	10%	23
Partnership Income / Grants	High	10%	16
General Price Increases:	Medium	Average of 3%	22
Capital - Property:			
Repairs & maintenance (sinking fund)	Medium	Est.	150
Capital - Vehicles			
Provision for future replacement of vehicles (sinking fund)	N/A	Est.	49
Known Commitments/Contracts			
Chagford Cattle Grid	N/A	Actual	3
Local Plan Review	N/A	Est.	122
All Moor Butterflies	N/A	Actual	18
MIRES PR14	N/A	Actual	10
2016/17 Project Fund allocations	N/A	Actual	138
Match Funding Reserve			
Greater Dartmoor LEAF	N/A	Actual	14
Naturally Healthy Dartmoor	N/A	Actual	10
Dartmoor's Wild Stories - HLF	N/A	Actual	19
Our Common Cause	N/A	Actual	8
National Parks Partnerships LLP	N/A	Actual	10
Public Arts Project	N/A	Actual	70
Moor Than Meets The Eye - match funding	N/A	Actual	150
Moor Than Meets The Eye - cash flow provision	High	C/F forecast	300
Unallocated to match future opportunities	N/A	Actual	144
Revenue			
Invest to save and / or Generate Projects	N/A	Actual	378
Annual Revenue Outturn to be allocated via the new MTFP		Estimated	26
General Reserve - Minimum amount to cover unanticipated costs / emergencies			450
Total Reserve Balance			**2,768**