City of Westminster Pension Fund

Funding update report as at 31 December 2017

Barnett Waddingham LLP

31 January 2018

Version 1

BARNETT WADDINGHAM
beyond the expected

Contents

BARNETT WADDINGHAM
beyond the expected

Introduction

Westminster City Council, as administering authority for the City of Westminster Pension Fund (the Fund), has asked that we carry out a quarterly monitoring assessment of the Fund as at 31 December 2017. The purpose of this assessment is to provide an update on the funding position.

The Fund participates in the Local Government Pension Scheme (LGPS). The LGPS is a defined benefit statutory scheme administered in accordance with Local Government Pension Scheme Regulations 2013 (the Regulations).

The information in this report is addressed to and is provided for use by Westminster City Council as the administering authority to the Fund. This report may be shared with other interested parties but it does not constitute advice to them.

This report complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) and Technical Actuarial Standard 300: Pensions (TAS 300) as issued by the Financial Reporting Council (FRC).

We assess the funding position on a smoothed basis which is an estimate of the average position over a six month period spanning the reporting date. As the smoothing adjustment reflects average market conditions spanning a six month period straddling the reporting date, the smoothed figures are projected numbers and likely to change up until three months after the reporting date. The smoothed results are indicative of the underlying trend.

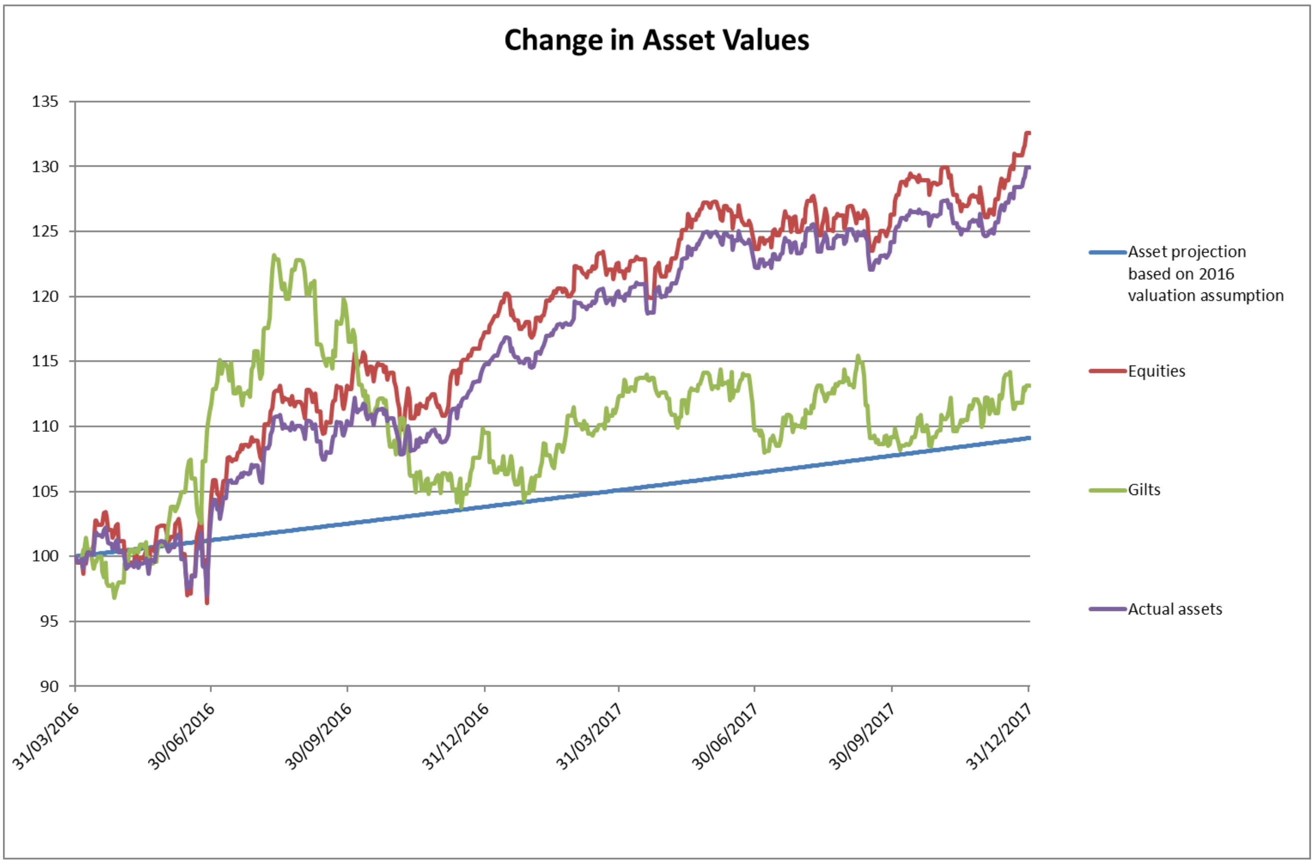
Assets

The estimated (unsmoothed) asset allocation of the City of Westminster Pension Fund as at 31 December 2017, based on data received from Westminster City Council, is as follows:

Assets (market value)	31 Dec 2017		30 Sep 2017		31 Mar 2016	
	£000s	%	£000s	%	£000s	%
UK and overseas equities	1,051,938	77.0%	997,704	76.4%	790,289	74.1%
Bonds	136,722	10.0%	154,415	11.8%	130,390	12.2%
Property	119,067	8.7%	114,739	8.8%	105,811	9.9%
Gilts	45,805	3.4%	28,675	2.2%	26,733	2.5%
Cash and accruals	13,039	1.0%	10,767	0.8%	13,120	1.2%
Total assets	**1,366,571**	**100%**	**1,306,302**	**100%**	**1,066,343**	**100%**

The investment return achieved by the Fund's assets in market value terms for the quarter to 31 December 2017 is estimated to be 4.6%. The return achieved since the previous valuation is estimated to be 29.9% (which is equivalent to 16.1% p.a.).

The following chart shows the changes in equity and bond markets since the previous actuarial valuation and compares them with the estimated actual fund returns and the expected fund returns assumed at the previous valuation:



As we can see the asset value as at 31 December 2017 in market value terms is more than where it was projected to be at the previous valuation.

Changes in market conditions – market yields and discount rates

The actual investment returns earned by the Fund will affect the value of the Fund's assets. The value of the Fund's liabilities, however, is dependent on the assumptions used to value the future benefits payable.

For the purpose of this exercise it is appropriate to use the method and assumptions consistent with those set by the Fund actuary for the purpose of the 31 March 2016 actuarial valuation, updated where necessary to reflect market conditions. Further details of the derivation of the financial and demographic assumptions can be found in the relevant actuarial valuation report.

Please note that from 15 May 2017 to 3 July 2017 the Bank of England (BoE) temporarily suspended the publication of their implied inflation curve (on which our RPI increase assumption, and so our CPI increase assumption, is based) while they carried out a review of their methodology. The BoE resumed publication of the implied inflation curve from 3 July 2017, however, they have also revised previous publications dating back to 1 January 2017. Our assumptions below take into account the new methodology from 1 January 2017.

The following table shows how the main financial assumptions have changed since the last triennial valuation:

Assumptions (smoothed)	31 Dec 2017		30 Sep 2017		31 Mar 2016	
	Nominal	Real	Nominal	Real	Nominal	Real
	% p.a.		% p.a.		% p.a.	
Pension increases (CPI)	2.73%	-	2.71%	-	2.39%	-
Salary increases	4.23%	1.50%	4.21%	1.50%	3.89%	1.50%
Discount rate	5.11%	2.38%	5.09%	2.38%	5.10%	2.71%

In addition to that, it is assumed that salaries increase in line with CPI until 31 March 2020.

The discount rate assumption is set with reference to the Fund's long term investment strategy and therefore reflects the long term expected return on assets for the Fund. Consistent with the method adopted for the 31 March 2016 valuation, we have included in the main discount rate assumption an explicit prudence allowance of 1.1%.

The key assumption which has the greatest impact on the valuation of liabilities is the real discount rate (the discount rate relative to CPI inflation) – the higher the real discount rate the lower the value of liabilities. As we see, the real discount rate is lower than at the 31 March 2016 valuation, increasing the value of liabilities used for funding purposes.

Results

The funding position for each month has been rolled forward from the formal valuation and is shown in Appendix 1. It should be borne in mind that the nature of the calculations is approximate and so the results are only indicative of the underlying position.

It is not possible to assess the accuracy of the estimated liability as at 31 December 2017 without completing a full valuation, however, we are satisfied that the approach of rolling forward the previous valuation data to 31 December 2017 should not introduce any material distortions in the results provided that the actual experience of the Fund has been broadly in line with the underlying assumptions, and that the structure of the liabilities is substantially the same as at the latest formal valuation.

The results of our assessment indicate that:

- The current projection of the smoothed funding level as at 31 December 2017 is 89.8% and the average required employer contribution would be 26.4% of payroll assuming the deficit is to be paid by 2038.
- This compares with the reported (smoothed) funding level of 80.0% and average required employer contribution of 29.1% of payroll at the 31 March 2016 funding valuation.

The main discount rate underlying the smoothed funding level as at 31 December 2017 is 5.1% p.a. The investment return required to restore the funding level to 100% by 2038, without the employers paying deficit contributions, would be 5.6% p.a.

Final comments

There are many factors that affect the Fund's funding position and could lead to the Fund's funding objectives not being met within the timescales expected. Some of the key risks that could have a material impact on the Fund include longevity risk and financial risks (including inflation and investment risk). There is more detail on this contained within the Fund's Funding Strategy Statement and the 31 March 2016 actuarial valuation report.

Note that the funding position at a future date will be dependent on the investment performance of the Fund as well as future market conditions which determine the financial assumptions.

We would be pleased to answer any questions arising from this report.

Graeme D Muir FFA
Partner
Barnett Waddingham LLP

BARNETT WADDINGHAM
beyond the expected

Appendix 1 Financial position since previous valuation

Below we show the financial position on a smoothed basis for each month since the previous full valuation. As the smoothing adjustment reflects average market conditions spanning a six month period straddling the reporting date, the smoothed figures for the previous three months are projected numbers and likely to change up until three months after the reporting date.

Please note that the results shown below are sensitive to the underlying assumptions. For example, increasing the discount rate assumption by 0.5% will increase the funding level by about 8%, and increasing the CPI inflation assumption by 0.5% will reduce the funding level by about 8%.

Smoothed Valuation date	Assets £000s	Liabilities £000s	Surplus / Deficit £000s	Funding level %	CARE ongoing cost (% of payroll)	Past service ctbn	Total ctbn (% of payroll)	Discount rate	Return required to restore funding level
31 Mar 2016	1,056,747	1,320,797	(264,050)	80%	16.9%	12.2%	29.1%	5.1%	6.1%
30 Apr 2016	1,069,276	1,336,290	(267,014)	80%	17.2%	12.6%	29.8%	5.0%	6.0%
31 May 2016	1,088,786	1,361,959	(273,173)	80%	17.7%	12.8%	30.5%	4.9%	5.9%
30 Jun 2016	1,103,684	1,383,592	(279,908)	80%	18.2%	13.0%	31.2%	4.8%	5.9%
31 Jul 2016	1,121,960	1,404,218	(282,258)	80%	18.6%	13.1%	31.7%	4.8%	5.8%
31 Aug 2016	1,133,402	1,420,778	(287,376)	80%	18.9%	13.3%	32.2%	4.8%	5.9%
30 Sep 2016	1,150,014	1,437,397	(287,383)	80%	19.3%	13.2%	32.5%	4.9%	5.9%
31 Oct 2016	1,172,816	1,449,340	(276,524)	81%	19.4%	12.7%	32.1%	4.9%	5.9%
30 Nov 2016	1,185,339	1,456,336	(270,997)	81%	19.5%	12.5%	32.0%	5.0%	6.0%
31 Dec 2016	1,206,192	1,462,395	(256,203)	82%	19.5%	11.8%	31.3%	5.1%	6.0%
31 Jan 2017	1,217,761	1,466,656	(248,895)	83%	19.5%	11.5%	31.0%	5.1%	6.0%
28 Feb 2017	1,237,696	1,476,136	(238,440)	84%	19.7%	11.1%	30.8%	5.1%	5.9%
31 Mar 2017	1,261,355	1,484,995	(223,640)	85%	19.8%	10.4%	30.2%	5.0%	5.8%
30 Apr 2017	1,272,196	1,485,224	(213,028)	86%	19.7%	9.9%	29.6%	5.0%	5.8%
31 May 2017	1,291,739	1,485,421	(193,682)	87%	19.6%	9.1%	28.7%	5.0%	5.7%
30 Jun 2017	1,297,593	1,482,855	(185,262)	88%	19.4%	8.7%	28.1%	5.0%	5.7%
31 Jul 2017	1,305,713	1,482,050	(176,337)	88%	19.2%	8.3%	27.5%	5.0%	5.7%
31 Aug 2017	1,308,966	1,479,801	(170,835)	88%	19.1%	8.1%	27.2%	5.1%	5.7%
30 Sep 2017	1,312,205	1,479,877	(167,672)	89%	19.0%	8.0%	27.0%	5.1%	5.7%
31 Oct 2017	1,325,951	1,484,899	(158,948)	89%	19.0%	7.6%	26.6%	5.1%	5.7%
30 Nov 2017	1,328,527	1,487,841	(159,314)	89%	18.9%	7.6%	26.5%	5.1%	5.7%
31 Dec 2017	1,341,651	1,494,515	(152,864)	90%	19.0%	7.4%	26.4%	5.1%	5.6%

Appendix 2 Data and assumptions

Data

In completing our calculations for pension accounting purposes we have used the following items of data, which we received from Westminster City Council:

- The results of the valuation as at 31 March 2016 which was carried out for funding purposes;
- Estimated whole Fund income and expenditure items for the period to 31 December 2017; and
- Estimated Fund returns based on Fund asset statements provided to 31 December 2017, and Fund income and expenditure as noted above.

The data has been checked for reasonableness and we are happy that the data is sufficient for the purpose of this report.

Full details of the benefits being valued are as set out in the Regulations as amended and summarised on the LGPS website and the Fund's membership booklet. We have made no allowance for discretionary benefits.

Assumptions

For the purpose of this exercise it is appropriate to use the method and assumptions consistent with those set by the Fund actuary for the purpose of the 31 March 2016 actuarial valuation, updated where necessary to reflect market conditions.

A summary of the main financial assumptions adopted is set out in the main body of this report.

The main demographic assumptions are:

- The post retirement mortality tables adopted are the S2PA tables with a multiplier of 80% for males and 85% for females. These base tables are then projected using the CMI 2015 Model, allowing for a long term rate of improvement of 1.5% p.a;
- The dependant post retirement mortality tables adopted are the S2PMA tables with a multiplier of 95% for males and the S2DFA tables with a multiplier of 100% for females. These base tables are then projected using the CMI 2015 Model, allowing for a long term rate of improvement of 1.5% p.a;
- Members retire at a single age, based on the average age at which they can take each tranche of their pension; and
- It is assumed that members will exchange 50% of their commutable pension for cash at retirement.

Further details of the derivation of the financial and demographic assumptions can be found in the relevant actuarial valuation report.