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Avon Pension Fund

Actuarial Valuation 2004

Implications for Council Tax in 2005



Actuarial Valuation 2004 – Implications for Council Tax in 2005

Introduction

There has recently been considerable press coverage of the prospective increase in contribution rates payable by Avon Pension Fund employers in the financial year 2005/2006 and beyond. The Council Tax implications for the four unitary councils was the main focus of the debate.

The purpose of this note is to explain the background to this issue and to set it in a broader perspective.

Local Government Pension Scheme/Avon Pension Fund

The Local Government Pension Scheme is one of a number of public sector schemes where the pension is earnings related. The amount of pension paid is based on length of service and final salary. The scheme is open to all "local government" employees except teachers and fire-fighters.

The Local Government Pension Scheme is a statutory scheme with nationwide coverage. Bath & North East Somerset Council is one of approximately 100 administering authorities in the United Kingdom and has responsibility for administration of the scheme in the former Avon area.

Unlike other public sector schemes the Local Government Pension Scheme is funded. This means that the contributions paid by employers and employees are invested until they are required to pay pensions. The principal argument in favour of having a funded scheme is that the pension entitlements of scheme members are funded by the people who currently benefit from the services provided by those members. However, "unfunded schemes" defer the financing of a substantial part of this cost into the future.

The Avon Pension Fund was established by Avon County Council in 1974 and since 1996 has been administered by Bath and North East Somerset Council. There are approximately 60 employing bodies with members in the Avon Pension Fund. The most significant of these are the four unitary Councils (Bath & North East Somerset Council, Bristol City Council, North Somerset Council and South Gloucestershire Council), three universities (Bath Spa University College, University of Bath and the University of the West of England), six further education colleges, Somer Community Housing Group and two branches of Connexions (Gloucestershire and West of England).

Against a background in which the Government is encouraging people to make greater provision for their pensions, the Local Government Pension Scheme fulfils a valuable role. It should not, however, be regarded as something separate from the overall remuneration package for local government staff.

The benefits payable by the Local Government Pension Scheme are not dissimilar to those available from final salary schemes generally. The average pension (including lump sum retirement grant) paid by the Avon Pension Fund in the financial year 2003/2004 was approximately £4,000. In this context the scheme's most valued attribute is its security. This security takes the form of the "pensions guarantee" which a statutory scheme provides and the earnings link.

Funding Shortfall

The Scheme regulations require that the Avon Pension Fund is valued every three years to determine the level of employer contributions needed to meet its past and future pension liabilities. At the last actuarial valuation in 2001 the Fund's assets virtually matched the value of its liabilities. In other words, the pension entitlements arising from members' service up to that date were fully funded. Because equity markets (both UK and overseas) fell sharply between 2001 and 2004, the Fund, like most funded schemes based on final salary, now has a funding deficit.

The Fund's actuary estimates that the Fund's assets will now meet only 80% of its liabilities. Legislation requires that the (estimated) 20% shortfall has to be met from an increase in employer contribution rates. The actual funding shortfall will not be known until after the current valuation is completed some time in October.

Apart from the problems created by investment returns being below expectations, there is an additional cost for all pension funds arising from the increased longevity of their members. After consultation with local authorities, the Government has now introduced amendments to the Local Government Pension Scheme which will have the effect of increasing the age at which scheme members can retire on a full pension. This will largely offset the higher longevity costs.

As already indicated, local authority pension funds around the country have suffered in the same way as the Avon Pension Fund. Although the Avon Pension Fund has the advantage of having one of the highest funding levels (meaning that employer contribution rates are below average), the scale of the increase in employer contribution rates required with effect from 1 April 2005 is unlikely to be much different from those of other funds.

Implications for Council Tax

The Government wishes to limit increases in Council Tax and has encouraged councils to consider extending the period over which deficits are recovered and "phasing in" the increases. It is possible that the four unitary councils in the Avon Pension Fund will adopt a recovery period of 20 years (as against the previous norm of 15 years) and phase in the increases over three years, both of which options have been agreed as reasonable by the Avon Pension Fund and the Actuary in the current circumstances.

Despite its stance on Council Tax, the Government has so far declined to meet its share of the contribution rate increases through higher revenue support grant. For councils around the country, this will exacerbate their financial problems and mean that they either have to increase Council Tax or reduce expenditure on services to a greater extent than would otherwise have been necessary.

Jean Hinks,
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