ANNEX 1

SERVICE PLAN & BUDGET REPORT 2024-27

1 Management Summary

Global markets were broadly favourable during 2023. Equities increased in value by 15% driven by US equities, while UK government bonds recovered as interest rate expectations declined. The Fund's portfolio value increased by 9% to £5,700m[1] and we enter 2024 in a robust financial position with 97% funding[1].

The Fund reviewed its investment strategy and executed material changes in 2023-24: equities are now split 50:50 across active and passive with materially lower fees, the Fund has reduced equity hedging from 100% to 50% to raise longer term growth potential, LDI hedging has been raised through higher leverage exposure to gilts, and the Fund confirmed £175m for Local Impact investing, initiated with a £50m investment in solar farms.

In addition, the new investment strategy confirmed more ambitious climate targets with the Fund's net zero date for its investments brought forward from 2050 to 2045. This target is underpinned by tangible near-term actions for the period 2024-30.

Looking forward to 2024-27, the Fund aims to: deliver reasonably predictable employer contributions, achieve investment growth which exceeds the Actuary's discount rate of CPI+2.5%, and deploy further capital into Local Impact investing.

Operationally the picture has been more mixed during 2023-24. Service performance in aggregate remains below required levels with only 5 of 18 service measures completed within target timescales. This is a result of high staff vacancy rates at the start of the period, regulatory changes e.g. McCloud, and the emergence of new challenges such as the Pension Increase issue which had to be promptly resolved.

To address the service challenge, we are driving key areas of action:

- People: the Fund will complete a new organisational structure and continue recruitment to build full capacity of 92 FTEs.
- Digital: we will develop digital communications and improve My Pension Online to enable simpler self-serve and drive operational efficiency.
- Control: we will review internal processes to drive control improvements and reduce operational risks.

On the regulatory front, we will fully implement the McLoud remedy before the regulatory deadline of August 2025, we will undertake preparatory work to ensure the Fund can meet all requirements of the Pensions Dashboard before the deadline in Q3 2025, and we will rectify all members impacted by the Minimum Pension Guarantee.

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[1] *31 December 2023*

2 Administration

2023-24 Review

The year has seen significant change – new regulations, digital improvements, new hires – while we also strengthened the quality of management information which is now embedded to inform workflow decisions and service priorities.

A pay review in Q2 2023 led to implementation of market supplements, raising officers' total pay to help staff retention. Recruitment has been a key focus and the vacancy rate has declined from 16% in April 2023 to 9% in March 2024. The Payroll team has been stabilised by the appointment of 3 senior payroll officers and a Payroll Manager is being appointed.

With 13 new staff joining and 25 internal movements during 2023-24, training has become critical. It takes 12-18 months to fully train a new pensions officer and it will take time for additional resources to feed into improved service. While capabilities are being developed, case backlogs remain high and service quality remains materially below target.

The Fund has also seen new challenges during the year which it has urgently addressed, e.g. the Pensions Increase project, systems issues in calculating the new McCloud underpin. With the creation of a Digital Services team to manage employer data and a new member website launched in February 2024, the Fund has started on its digital journey.

Objectives 2024-25

Administration actions over 2024-25 are designed to drive three core objectives: meet regulatory requirements, improve service experience, and drive operational efficiency. Key actions include the following:

1. *Regulations: meet regulatory requirements*
   - Pension Increases: the Fund has already recompensed c.700 affected members and plans to complete all corrections before the end of 2024.
   - McCloud: we will fully implement the remedy before the regulatory deadline of August 2025, which will require material preparatory work during 2024.
   - Pensions Dashboard: we will also undertake preparatory work to ensure the Fund can comply with all requirements before the deadline in Q3 2025.
   - Guaranteed Minimum Pension: following reconciliation of the data we will rectify all members impacted.
   - The Fund will comply with other regulatory changes as required.

2. *People: improve service, drive operational efficiency*
   - The Fund will complete the new organisational structure already started. This includes a better resourced Payroll function and a new Business Change team to support transformation and key projects. Headcount will increase from 85 to 92 FTEs.
   - And we will continue recruitment to build up to full capacity.
   - The Fund will implement a pensions-specific pay structure with the B&NES HR team, removing need for market supplements, which will help to retain and recruit staff.
   - APF leadership is also focused on training, development, and communication, to improve staff engagement and strengthen their sense of connection with the Fund.

3. *Digital: improve service, drive operational efficiency*
   - We will continue to develop digital communications for all stakeholders, through improved online content and web experience.
   - The Fund will improve ‘My Pension Online’ to enable simpler self-serve.
   - We will upgrade the employer website encouraging employers to self-serve.

4. *Control: meet regulatory requirements, improve service, drive operational efficiency*
   - We will undertake a review of internal processes across our administration, to drive control improvements (e.g. annual / quarterly checks) and reduce operational risks.
   - The Fund will further improve information and reporting, to inform management and decisions around service priorities.
   - We will automate key processes and aggregate tasks into groups which can be processed in bulk.

3 Investments & Funding

2023-24 Review

An investment review concluded in 2023-24 with new climate targets and revised equity hedging. Significant engagement with stakeholders was an integral part of the climate review and informed the Committee’s final decisions in December 2023.

The Fund’s net zero target for its investment was brought forward from 2050 to 2045, underpinned by tangible action and targets during 2024-30 which will be reviewed annually:

- *Carbon Intensity vs 2019 baseline:*
  - The Fund will reduce carbon intensity of its equities 43% by 2025 and 69% by 2030
  - The Fund will reduce carbon intensity of its corporate bonds by 60% in 2030

- *Divestments:*
  - By 2030 the Fund will divest from developed market equities not aligning to achieve net zero.

- *Engagement with companies:*
  - By the end of 2024, 70% of emissions in material sectors will be covered by active engagement, with 90% covered by 2027.

With bond yields at attractive levels, the liability matching strategy was reinstated with maximum leverage 40% of fund assets. In addition the hedge ratio for equity protection was reduced from 100% of equity value to 50%, to release collateral and improve long term portfolio growth potential while maintaining material downside protection.

During the year a captive Death in Service insurance arrangement was put in place, to shield individual employers from one-off costs which are now shared. Work to reduce investment risk for some of the smaller employers has continued, by enabling employers to switch to the Lower Risk Investment Strategy.

Asset values increased during the year and now stand at c.£5.7 billion[2]. However as inflation expectations have fallen, bond yields have declined and a lower discount rate has raised the present value of liabilities, which has offset the increase in assets. Hence the net funding position has remained broadly stable at c.97%[1].

Objectives 2024-25

The Fund aims to achieve predictable employer contributions, through an investment strategy of acceptable risk which seeks to grow assets more quickly than the Fund's actuarial assumptions. Key focus areas during 2024-27 include the following:

Triennial Valuation:
- This will be in 2025 and comprises the valuation and funding plan.
- It will embed prudence into assumptions for future investment returns, to reduce the risk of the funding level not reaching 100% over the medium term.
- Once the funding level exceeds 100%, the Fund will face a strategic choice between lower contributions vs a lower risk investment strategy.
- An interim valuation will be undertaken in 2024[3]. This will highlight cost pressures and materials swings in assets and liabilities, to help employers with their budgeting.

Investment Strategy:
- A review of the investment strategy will be conducted in 2025-26 following the valuation, to ascertain the optimal strategy to deliver the funding plan.
- This will be framed in the context of employer needs such as their risk appetite and interest in predictable contributions.
- The review will focus on: asset growth targets, asset allocation, volatility, and the implications of different strategies for employer contributions and funding.

Local Impact
- During 2023-24 the Fund made its first investment, committing £50m to Wessex Gardens' 16 solar farms alongside 5 other LGPS funds[4].
- During 2024-25 the Fund aims to deploy further capital and is actively exploring specific opportunities in Affordable Housing and SME Funding.
- The Fund will also explore Nature Based Investing to assess how this could be included in our investment strategy and be implemented.
- There will also be projects to consider the government's Levelling Up and Private Equity ambitions for LGPS funds and the pooling of remaining legacy assets.

Climate Change
- The Fund will implement actions required to achieve its climate targets (listed above).
- Administered by B&NES Council, the Fund is committed to the Council's goal of Net Zero 2030 in respect of its own operations. It will achieve this by digitising service, using technology to enable remote working, and through occupying carbon efficient offices.
- Responsible investment objectives are kept under regular review as government policies evolve and technology enables targets to be accelerated over the next 5-10 years.

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[2] *31 December 2023*

[3] *reflecting assets and liabilities from 31 March 2024*

[4] *in partnership with Cornwall, Devon, Gloucestershire, Wiltshire, Oxfordshire. Aggregate partnership investment £330m.*

Employers

- The focus during 2024-27 will be on managing employer admissions and exits.
- The Fund will undertake annual covenant checks on employers to assess employer-specific risks. Such assessments are critical to identify employers which may face funding issues, so we can work with them to manage pension costs and minimise financial risks.
- We will continue to ensure scheme exits are viable without adversely impacting the Fund.

4 Governance

Good Governance Review (GGR)

- The Scheme Advisory Board's review sets out recommendations to improve governance of LGPS. Statutory guidance necessary for the recommendations to take legal effect is expected to be published this year.
- The Fund has taken action to comply with draft requirements and during 2024 the Fund will implement any additional requirements from the Scheme Advisory Board's GGR.

General Code of Practice (GCOP)

- The Pension Regulator confirmed that its GCOP will come into force on 27 March 2024, consolidating 10 separate Codes into a single Code.
- In 2024 the Fund will review the Code's requirements and put in place actions to comply including new requirements such as cyber security.

Knowledge & Skills

- Both Committee and Board members committed in 2023 to complete Hyman's Learning Academy modules and this now forms a mandatory part of the Fund's Training policy.
- Achieving compliance in line with our policy will be a priority for 2024-25.

Audit

- Audit attention is increasing and the 2024-25 Audit Plan will focus on a few critical areas.

	Timing	Days' work
Pensions Payroll	Apr-June	15
Annual Benefit Statement	Apr-June	20
Internal Control Framework	July-Dec	30
Employer Data Security	July-Dec	20
General Code – implementation	Oct-Dec	20
Local Impact Investing – governance	Jan-March	25
TOTAL DAYS		130

Pension Board Membership

- The Fund will undertake a recruitment exercise this year to recruit new Member and Employer Representatives to replace existing members as their terms come to an end.

Risk Management

- The Fund will review and update its Business Continuity Plan to ensure it remains fit for purpose and resilient vs new threats.
- The Fund will also identify key risks and undertake mitigating actions to reduce the Fund's aggregate risk exposure.

5 Regulatory Update

Projects for McCloud and the Pensions Dashboard are already in place.

McCloud regulations came into force in October 2023, with the Fund applying the rules to new cases such as retirements. For the McCloud Remedy (retrospective application to those members who have left or retired) numbers of impacted members still needs to be confirmed and guidance from DHLUC is not yet final. There remains significant work to implement the remedy in full in terms of calculations and communications, which the Fund will complete before the regulatory deadline in Q3 2025.

For the Pensions Dashboard, the LGA issued draft guidance in November 2023. The required connection date will likely be July-September 2025 and exact staging dates will be published in due course by the Money & Pensions Service. The Fund will comply with all requirements of the Pensions Dashboard.

We regularly review guidance and bulletins from the LGA and there are regular meetings with Mercers to discuss regulatory changes. The Fund will continue to review and update systems, processes and documents to ensure compliance with any new regulations.

There are also 'business as usual' projects which are regulatory, e.g. members' annual benefit statements and statements for the annual allowance. Planning and delivery of these projects is managed by the Quality Assurance Team and such projects will be managed during 2024-25 to meet all regulatory deadlines.

6 Communications

In 2023-24 the Fund made progress communicating its objectives and ethos including:
- Active engagement with over 5,000 members completing our net zero investment review survey and with 170 plus attendees (including Councillors) at 11 engagement sessions across our region.
- Securing media coverage for our net zero 2045 plans.
- Coverage of recent investment in Wessex Gardens solar.

Example coverage includes: Pensions Age and Pensions Expert.

We distributed over 120,000 member newsletters and have driven 300% growth in the Fund's social media followers on LinkedIn. Furthermore, the Fund's continued drive to use digital channels reduced our carbon footprint and yielded cost savings exceeding £30,000 by using email to distribute newsletters, Annual Pension statements, and other materials.

The Fund launched its new website www.avonpensionfund.org.uk.on 29 February 2024. Our former website had to be replaced and we used the opportunity to improve our online service. The new website is more user-friendly, with fresh features enabling members to access information they need and tell us simple changes such as their new address. The new website is part of the Fund's own digital improvement journey and we will make regular refinements during 2024-27.

The Fund has several communications objectives for 2024-25:

- *Regulatory:* the first and most important objective is to support our administration teams in meeting regulatory commitments, e.g. timely production of Annual Benefit Statements, publishing documents like the Annual report, etc.

- *Understanding:* the Fund needs to communicate with its diverse stakeholders, to deepen members' understanding of their pension and convey the long term strength of the Fund. We need to combine this with explaining how we implement our climate ambitions and progress towards net zero.

- *Digital adoption:* a critical objective is to maximise members' adoption of My Pension Online (MPO) which supports improved service and higher operational efficiency. This year's campaign will focus on maximising take up among active members and new joiners.

7 Budget & Cashflow Forecast 2024-27

The 2024-25 budget of £31.4m is £0.4m (-1%) below the £31.8m budget of 2023-24.

	2023-24		2024-25	Change
£ millions	Forecast	budget	budget	2025 vs 2024
Admin & Governance	6.6	6.9	8.7	+1.8
Investments	22.8	24.9	22.7	-2.2
Total	29.4	31.8	31.4	-0.4

The essence of the 2024-27 budget is that reduced investment costs – driven by shifting assets from active to passive and lower assets with managers on performance fees – create headroom for higher administration costs and additional FTEs required to improve service and controls in the Fund.

Administration & Governance

The administration budget of £8.7m for 2024-25 is £1.8m higher than 2023-24. Five core drivers explain the majority of this difference:

- £0.6m: the new organisational structure – with 95 FTEs – includes new posts required to improve service, tighten control, and meet regulatory obligations. New posts include the Payroll Manager and Head of Business Change.
- £0.3m: expected annual 5% pay rise in 2024-25 and other costs.
- £0.3m: contingency for salary reviews being undertaken with Korn Ferry.
- £0.3m: investment and actuarial advice
- £0.2m: system developments including 'advanced admin to pay' and data cleansing

The Fund is required to meet costs of the Pensions Board, for which estimated costs are included in the 3-year budget.

Investment Costs

2024-25 investment fees of £22.7m are £2.2m (9%) lower than the £24.9m budget of 2023-24. Lower investment fees are primarily driven by the shift from active to passive management, and projected performance fees reducing as the Fund will have fewer assets with IFM the infrastructure manager.

Investment costs include Brunel fees which manages £5.1 billion (89%) of Avon assets[5]. Estimated fees for 2024-25 assume current mandates are retained, though actual fees will depend on asset values and performance. Avon's estimated share of Brunel costs is c.13% or £1.9m pa (3 bps). The increase over current year budget is largely driven by inflation, re-tendering existing contracts, and higher pension costs.

Cashflow

As Fund membership matures, monitoring cash flow trends becomes increasingly critical.

The Fund has now passed through an inflection point from being cash flow positive (contributions exceed benefits) to cash flow negative.

Owing to advance future service payments from major employers and deficits paid in advance by other employers in April 2024, the Fund will enjoy high cash in-flows at the start of the financial year, followed by greater negative monthly cash flows mitigated by using investment income and divestments.

The Fund is expected to experience £27m of net cash outflows in 2024-25. Full details of the budget between 2024-27 together with a cash flow forecast for the payment of benefits and the receipt of contributions are in Appendix 3.

[5] 31 December 2022