Pensions Sectoral Joint Committee

Item no: 4

Finance Report and update on MTFS

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Date:	Date 1st December 2017		
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Summary: This report provides an update on the financial results for the six months actuals and the forecast to the end of the financial year 2017/18, including cash flow, capital adequacy calculations and a request to bill the balance of the Development Funding Charge.

Recommendations:

The Committee is recommended :-

1. To note the finance report and
2. To confirm the Development Funding Charge for the financial year 2017/18 and
3. To note the status of the MTFS

1. Finance Report

Income Statement

This report provides an update to the Committee on the income and expenditure for the six months actuals and the six months' forecast to March 2018.

Income Statement

	1H Actual	2H Forecast	Full Year Forecast	MTFS	Variance	Notes
Service Charge	1,600,000	1,600,000	3,200,000	3,200,000		
Fund Income	600,917	681,762	1,282,678	1,250,576	32,102	
LGIM Fees	127,583	136,029	263,612		263,612	1
Total income	2,328,500	2,417,791	4,746,291	4,450,576	295,715	
Facilities	(156,795)	(199,268)	(356,063)	(359,256)	3,193	
Staff Costs	(858,173)	(1,362,611)	(2,220,784)	(2,318,220)	97,436	2
Legal & Professional	(369,316)	(847,111)	(1,216,426)	(1,231,000)	14,574	3
Travel & General Expenses	(26,539)	(19,222)	(45,761)	(67,375)	21,614	
Technology	(12,368)	(224,023)	(236,390)	(308,458)	72,068	4
Data Services	(55,568)	(65,298)	(120,866)	(110,000)	(10,866)	
Total Costs	(1,478,759)	(2,717,532)	(4,196,291)	(4,394,309)	198,018	
Interest Income	4,255	6,900	11,155	15,000	(3,845)	
Depreciation	(1,078)	(1,578)	(2,656)	(1,842)	(814)	
Net Profit	852,918	(294,420)	558,498	69,425	492,918	
AUM	£5.5bn	£7.2bn		£6.3bn		

Comments on the major variances on the forecast for the full year compared to the MTFS are as follows:-

1 -LCIV's agreed fee of 0.5bp for negotiating lower fees with LGIM was not included in the MTFS as the PSJC agreed to this arrangement after the MTFS was approved. The agreed fee is calculated monthly and will be billed to the LLAs annually in arrears in April 2018.

2 Timing differences on staff recruitment which were budgeted in the MTFS to start earlier than has been achieved have led to the positive expense variance. In addition, staff turnover which was not forecast has impacted staffing levels and the recruitment target in the year. We anticipate that headcount will be @15 by year end (currently at 12) and that the recruitment for the additional ten staff as set out in the MTFS will continue in 2018/19.

3 After the MTFS was approved by the PSJC, it was agreed by the Board, the PSJC and input from Treasurers that third party professional fees incurred in respect of fund launches should be charged to funds rather than being expensed in the management company as this was considered to be an equitable allocation of costs relating to fund launches.

4 Technology, systems and related consulting costs have yet to be incurred in respect of the target operating model and systems development. Work began working with the consulting firm Alpha, who are working with a number of other pools including Brunel and Borders to Coast, in October and the initial discovery and analysis phase with recommendations are due to report to the Board in mid December. The project focuses on three areas, investment oversight, client reporting and data management.

The investment oversight systems required will trigger a full OJEU process due to the contract values being in excess of OJEU limits and subject to Board approval will commence in January. LCIV is looking to implement the client reporting and client management during the first quarter of 2018 subject to Board approval and this has been included in the forecast for the second half of the year.

It should also be noted that at this point it is unclear what impact, if any, the governance review will have on the forecast and this will need to be considered in due course.

The forecast AUM at the end of the year is £7.2bn, ahead of the MTFS of £6.3bn. Market move to October has accounted for £500m of the increase which was not factored in to the MTFS with additional subscriptions of @£400m covering the balance.

The table below shows the AUM of LCIV at the end of September and forecast AUM at the end of March. The number of boroughs with investments on the ACS platform is expected to increase to 22 and the number of boroughs benefitting both from either direct investment or fee reduction on the passive investment is forecast to be 27.

	Total AUM 31/03/17 £m	Passive*	Cash	Available Assets	LCIV Assets 30/09/17 £m	% of LLA AUM	Anticipated LCIV Assets 31/03/18 £m	% of LLA AUM
Barking & Dagenham	916	196	9	711	345	48	507	71
Barnet	1,052	405	14	633	134	21	138	22
Bexley	804	-	-	804	370	46	382	48
Brent	804	355	100	349	126	36	131	37
Bromley	894	-	-	894	-	-	-	-
Camden	1,517	528	21	968	245	25	254	26
City of London	926	-	-	926	-	-	-	-
Croydon	1,021	576	-	445	-	-	-	-
Ealing	1,092	-	48	1,044	376	36	390	37
Enfield	1,077	245	44	788	49	6	216	27
Greenwich	1,234	529	12	692	-	-	-	-
Hackney	1,282	312	-	970	-	-	180	19
H&F	982	279	14	689	231	34	299	43
Haringey	1,248	1,000	25	223	-	-	100	45
Harrow	770	253	8	509	90	18	153	30
Havering	648	97	13	538	301	56	312	58
Hillingdon	931	215	-	716	103	14	247	35
Hounslow	933	159	10	764	-	-	52	7
Islington	1,255	309	-	946	295	31	305	32
K&C	1,047	291	74	682	-	-	-	-
Kingston	760	-	2	758	79	10	152	20
Lambeth	1,313	-	20	1,293	371	29	519	40
Lewisham	1,225	1,044	1	180	-	-	-	-
Merton	623	450	-	173	-	-	-	-
Newham	1,335	344	113	879	-	-	-	-
Redbridge	743	238	2	504	264	52	273	54
Southwark	1,431	809	-	622	-	-	-	-
Sutton	591	69	11	511	185	36	192	38
Tower Hamlets	1,368	266	13	1,089	567	52	587	54
Waltham Forest	807	-	1	806	-	-	320	40
Wandsworth	2,093	551	23	1,519	832	55	860	57
Westminster	1,212	287	-	925	558	60	708	76
Total	**33,934**	**9,806**	**578**	**23,550**	**5,522**	**23**	**7,277**	**31**

* Highlighted AUM is covered at least in part by LCIV negotiated rates

The following table sets out the funds launched by LCIV to date and planned launches before the end if the financial year. Further details are set out in the fund launch report.

	Planned		Actual	
	Date	AUM	Date	AUM
Allianz Global Equity Alpha			Dec-15	507
Baillie Gifford - Diversified Growth			Feb-16	511
BG Global Alpha Growth	May-16	1,455	Apr-16	931
Pyrford - Global Total Return	Jun-16	200	Jun-16	188
Ruffer - Absolute Return	Jun-16	335	Jun-16	301
Newton - Real Return	Dec-16	330	Dec-16	321
Majedie - UK Equity	Apr-17	530	May-17	526
Newton - Global Equity	Apr-17	500	May-17	666
Longview - Global Equity	May-17	450	Jul-17	286
EPOCH Income Equity	Sep-17	200	Nov-17	140
HD Emerging market equity	Sep-17	200	Jan-18	80
RBC sustainable equity	Sep-17	200	Jan-18	180
Global Equity 4	Dec-17	150	Under review	
Global Equity 5	Dec-17	150	Potential low carbon tracker off ACS	

Cash flow and Balance Sheet

The cash flow analysis below shows cash movement for the first six months of the year and the forecast to March 2018. The service charge of £25k and the DFC of £50k per shareholder was invoiced in April 2017 and represents the large cash inflow in Q1.

The forecast for the second half of the year includes the balance of the DFC totalling £800k being invoiced in December and paid before the end of March 2018. Cash balances are held by Barclays Bank.

The Committee is asked note that although the fund set up costs are not expensed in LCIV and charged to the relevant sub-fund, LCIV funds the expense and recovers from the fund over a two year period so that LCIV is cash flow negative during this recovery period. At the end of September LCIV had funded £215k on behalf of fund launches.

In addition, service charges are outstanding from the following boroughs:-

Camden	£90,000
Kensington and Chelsea	£90,000
Newham	£90,000
Wandsworth	£90,000

In respect of income and expenses, management fee income and expenses generally cycle on either a monthly or quarterly basis.

Cashflow for the year 2017/18

	Q1 Actual	Q2 Actual	Q3 Forecast	Q4 forecast
Service Charge	1,425,000	525,000	450,000	800,000
Fund Income	263,437	337,480	340,881	340,881
LGIM Fees				
Cash inflow	1,688,437	862,480	790,881	1,140,881
Facilities	(121,894)	(134,901)	(99,634)	(99,634)
Staff Costs	(364,157)	(494,016)	(592,209)	(770,402)
Legal & Professional	(215,911)	(252,816)	(370,762)	(476,349)
Travel & General Expenses	(8,618)	(17,921)	(9,172)	(10,050)
Technology	(7,176)	(5,192)	(10,973)	(213,050)
Data Services	(27,255)	(28,313)	(32,649)	(32,649)
Net cash outflow	(745,011)	(933,159)	(1,115,399)	(1,602,134)
Net cash movement	943,425	(70,678)	(324,518)	(461,253)
Opening cash position	4,291,340	5,234,766	5,164,087	4,839,569
Closing cash position	5,234,766	5,164,087	4,839,569	4,378,316

The balance sheet for LCIV is set out below. The balance sheet is straightforward as there are very few capital assets. The premises and equipment are licensed from London Councils on an annual license, invoiced quarterly. LCIV currently pay £14k per desk pa which will increase in 2018/19 to £17k per desk pa.

Balance Sheet	Actual Mar-17	Actual Sep-17	Forecast Mar-18
Non Current Assets	4,800	3,723	3,223
Current Assets	4,604,860	6,197,791	5,138,188
Current Liabilities	(299,613)	(1,038,546)	(272,866)
Non Current Liabilities	(831,000)	(831,000)	(831,000)
Net Assets	3,479,047	4,331,968	4,037,545
Capital and Reserves	4,950,033	4,950,033	4,950,033
Profit & Loss Account	(1,470,986)	(618,068)	(912,488)
Net Capital	3,479,047	4,331,965	4,037,545

Capital Adequacy

The calculation of regulatory capital follows a proscribed formula whereby the capital requirement is based on the higher of 0.02% of assets under management plus the GBP equivalent of Eur250m, compared to a quarter of the annual audited expenditure (excluding extraordinary items).

The Committee will note from the table below that the capital requirement is expected to increase by @£850k this year as the AUM increases from £3.6bn to £7.2bn. A condition of the capital adequacy calculation is that current year profits are not allowed as an asset until audited. Consequently, the forecast surplus this year will be included in permitted capital next year and improve the capital position of LCIV.

The Committee is asked to note that the FRS102 accounting deficit discussed at the PSJC meeting in July is currently included as a reduction in the surplus regulatory capital. After the exercise to address the accounting impact has been resolved, it is expected that the capital position will be increased by £831k if the resolution can be achieved before the end of the financial year.

CAPITAL ADEQUACY	Actual Mar 2017	Actual Jun 2017	Actual Sep 2017	F'cast Mar 2018
AUM	3,575	4,940	5,557	7,277
A = Initial Capital - Euro 125k	106	109	110	110
B = 0.02% of AUM in Excess of EUR 250 Mn	673	944	1,067	1,411
C = Quarter of Operating Expenses	556	576	576	576
Regulatory Capital Requirement	779	1,053	1,177	1,521
Share Capital	4,950	4,950	4,950	4,950
Retained Earnings	-1,471	-1,471	-1,471	-1,471
Current Year P&L	0	485	853	558
Total Reserves Carried Forward	3,479	3,964	4,332	4,037
Surplus/Deficit Regulatory Capital	2,700	2,426	2,302	1,958

note: current year reserves do not qualify for regulatory capital purposes

Recommendation

The Committee is asked to note the finance report.

2. Development Funding Charge ('DFC')

As the Committee is aware the DFC was designed to provide funding to LCIV necessary to support and deliver its objectives of generating cost savings and improved investment performance, which invariably requires upfront funding of costs as AUM grows over time. Over the last 12 months LCIV has grown the AUM from £3.6bn to its forecast level of £7.2bn, ahead of the MTFS AUM of £6.3bn as further funds are launched.

It was agreed with the PSJC that the DFC should be split into two parts, two thirds in April and the balance in December. Based on the foregoing financial analysis, it is recommended that the balance of the Development Funding Charge should be billed in order to ensure that the business is adequately funded to deliver benefits to stakeholders and investors. The Committee is asked to note that the DFC is an important source of funding for LCIV whilst it builds AUM. The balance of the DFC for 2017/18 totals £800k and will ensure that LCIV avoids a forecast financial loss in the year which would further erode LCIV's regulatory capital. The intention of the B shares was to provide a contribution towards the Regulatory Capital Requirements of LCIV capital funding and not funding of the operating expenses of LCIV (s3.2 of the Shareholder Agreement).

As mentioned in the finance report, LCIV is progressing recruitment and infrastructure development, although progress has not matched the MTFS, the Committee should note that favourable expense variances are timing differences rather than unnecessary expenditure. The DFC ensures that the regulatory capital of the business, which will be impacted by the growth in AUM, is not being additionally eroded through operating losses. LCIV still expects the DFC to reduce from its current level of £75k to £10k per shareholder over the next four years when AUM is forecast to be at £15bn and so the Committee is recommended to confirm the charging of the DFC of £25k per shareholder. This recommendation has also been discussed and agreed with the Board and LFAC.

Recommendation:

The Committee is recommended to confirm the charging of the full Development Funding Charge for the financial year 2017/18

3. **Medium Term Financial Strategy**

At the time of drafting this report, the Committee is asked to note that the MTFS is currently in progress and a draft is being presented to the Board for discussion on the 13th December. Following this meeting and subject to any comments from the Board, the updated MTFS will be circulated to the Committee for discussion and adoption at the next PSJC Committee meeting at the end of January. This timeline meets with the requirements of the Shareholder Agreement (s6.4).

Recommendation:

The Committee is recommended to note the status of the Annual Budget and MTFS.

Financial Implications

The financial implications are contained within the body of the report.

Legal implications

There are no legal implications for the Committee that have not been considered in the report.

Equalities implications

There are no equalities implications for the Committee.

Brian Lee

1st December 2017