Housing briefing, July 2021
Annual FRS 102 survey – Latest 2021 results

This briefing highlights initial findings from our second annual survey looking at FRS 102 assumptions and results for the social housing sector. So far, our survey has covered 216 separate accounting disclosures, with more than £11bn in pension accounting liabilities in total. Our annual survey – the biggest Defined Benefit (DB) pension survey of the sector – provides a powerful insight into the funding of the sector's DB liabilities.
It's not too late to take part – to respond to the survey, please email Sam Mullock or John Fitzgerald.

Key early findings

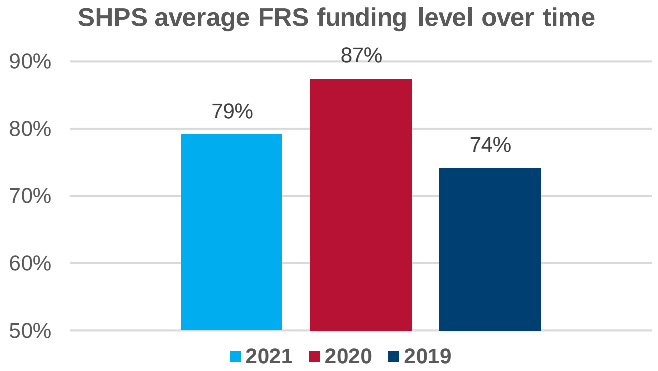
1. Funding levels have fallen, with SHPS hit particularly hard by an 8% average fall in FRS 102 funding levels.
2. Our analysis suggests that SHPS only needs 3.4% pa returns to pay benefits without further contributions.
3. Ex-SHPS schemes still have a higher funding level than SHPS.
4. Average LGPS funding levels are remarkably stable over the last 3 years (despite high equity allocations).
5. It's harder than ever to set a long-term CPI assumption (survey assumptions range from 2.3% to 3.1% pa).

Significant drop in SHPS funding level

For SHPS, the aggregate FRS 102 funding level deteriorated over the year to 31 March 2021.

This was caused by increased liabilities resulting from a fall in discount rates and a rise in gilt market implied future inflation.

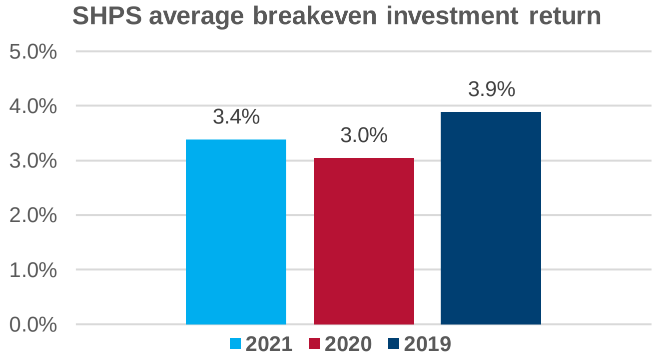
The value of SHPS assets also increased over the year, but not as much as some other schemes, such as LGPS, (which benefited to a greater extent from the c40% return from global equities over the year).



SHPS breakeven return – a realistic target?

FRS 102 valuations aren't used to determine cash contributions, but they can still provide a helpful insight into pension scheme funding.

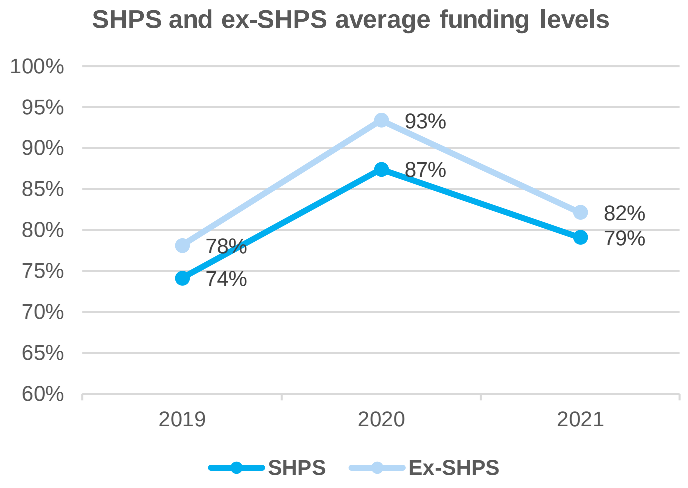
Our analysis shows that if investment returns of 3.4% pa could be achieved for the lifetime of SHPS, there would be enough money to pay benefits without any further employer deficit contributions. While this return appears low compared to historical returns, associations will be aware of the current low yield economic environment (which benefits associations raising financing from bonds).



Ex-SHPS schemes remain better funded

More than £2bn of liabilities have now been 'bulk transferred' out of SHPS to single employer DB schemes. The latest transfer – the largest to date – is The Guinness Partnership, which was advised by First Actuarial.

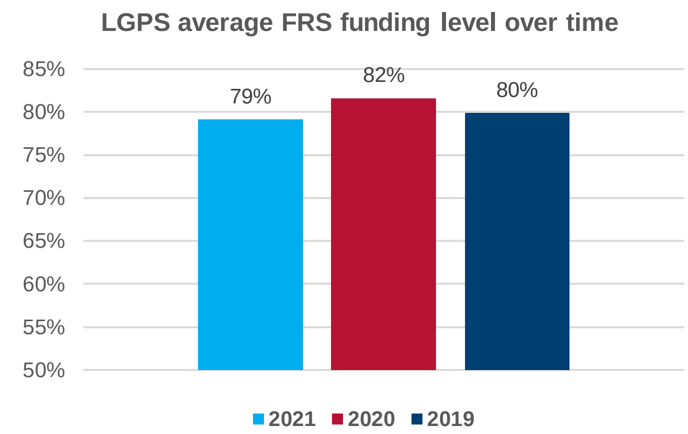
A key reason to transfer is to set a funding and investment strategy suitable for an individual employer's circumstances. Most employers have initially used this flexibility to set a bespoke strategy by increasing the pace of funding with higher deficit contributions. Our survey confirms this, with ex-SHPS schemes having a higher funding level.



LGPS funding remarkably stable

LGPS funds invest in a higher proportion of growth assets (such as equities) than most DB schemes (such as SHPS). This is because the LGPS is an open scheme with a long-term time horizon, generally backed by strong employer covenants.

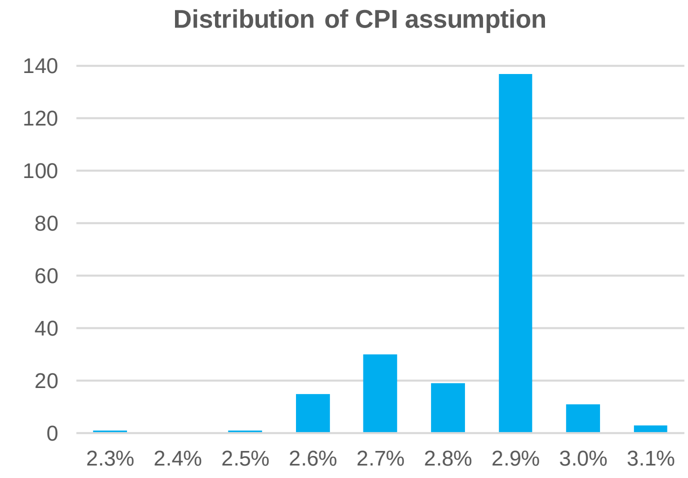
This strategy is expected to lead to lower long-term costs for employers (compared to a more defensive assets allocation) but greater short-term funding volatility. However, our survey shows the opposite – that LGPS funding levels have been relatively stable over a three year period.



It's harder than ever to set a CPI assumption

The starting point for inflation assumptions has historically been the gilt market implied RPI inflation curve. This approach results in a risk that the 'gilt market implied' rate will be different from actual expectations of future inflation.

Many commentators now argue that the gilt market overstates inflation expectations after 2030 (when RPI and CPIH will be aligned). This year, we have seen an increased number of employers make an adjustment to gilt market implied inflation. This has led to a wide range of CPI inflation assumptions (and to a lesser extent RPI inflation assumptions). Most employers are assuming that CPI will be higher than the Government's target of 2% pa. The difference between the top and bottom figures in our survey could impact liabilities by over 15%.



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Discount rates tightly bunched

The key assumption used to value liabilities is the discount rate. FRS 102 states that this must be derived from “market yields at the reporting date on high quality corporate bonds”. The higher the discount rate, the lower the assessed value of the liabilities. Although the discount rate is derived from the yield on high quality corporate bonds, there is a range of reasonable assumptions.

Even though different assumptions can be justified, the vast majority of results in our survey used a discount rate between 2.0% pa and 2.2% pa. The sector average assumption is 2.1%, which compares to a figure of 2.3% used last year. This fall in discount rates is a key reason why the majority of DB schemes have seen a fall in their FRS102 funding level over the year.

Benchmark your FRS102 results and assumptions

FRS 102 valuations provide a useful insight into pension scheme funding. However, they are not used to determine cash funding. Instead, for cash funding, liabilities are valued on different (sometimes more prudent) actuarial assumptions, and there are different (even more prudent) assumptions again for exit valuations.

To better understand your DB obligations and benchmark your FRS 102 results against our survey please get in touch with the survey’s authors or one of our housing team.

Sam Mullock (survey author)

Sam is a partner and an actuary working in our Manchester office. His clients include some of the UK’s biggest housing associations. Sam is a recognised industry expert on SHPS bulk transfers and is regularly quoted in the sector’s publications on this topic.

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