Social housing FRS 102 survey 2021

This briefing sets out the final results from our second annual survey looking at FRS 102 results and assumptions for the social housing sector. Our survey covers 232 results, representing over £11bn in pension accounting liabilities. This makes it the biggest Defined Benefit (DB) pension survey of the sector, providing powerful insights into the funding of its DB liabilities.

Key trends at a glance

The aggregate FRS 102 funding level decreased from **85%** as at 31 March 2020 to **80%** as at 31 March 2021.

Ex-SHPS schemes in the survey (created after a bulk transfer) have retained a higher aggregate funding level than SHPS, despite volatile market conditions.

The aggregate asset value – for results in our survey – increased from **£6.1bn** as at 31 March 2020 to **£7.2bn** as at 31 March 2021.

Accounting liabilities increased by **25%** (including new benefit accrual) over the year. In 2021, the range of reasonable assumptions can change the value of the liabilities by up to **10%.**

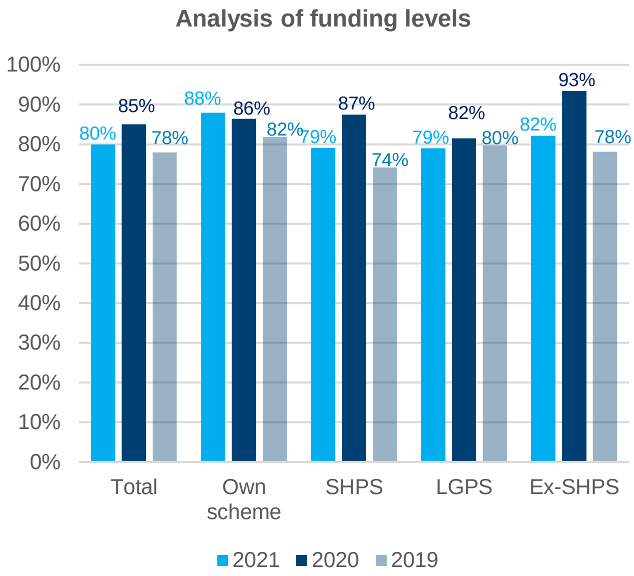
It's harder than ever to set a long-term CPI assumption (survey assumptions range from 2.6% to 3.1% pa).

If investment returns of **3.2% pa** can be achieved for the lifetime of scheme members then there is enough money to pay benefits without any further employer deficit contributions.

Funding Levels

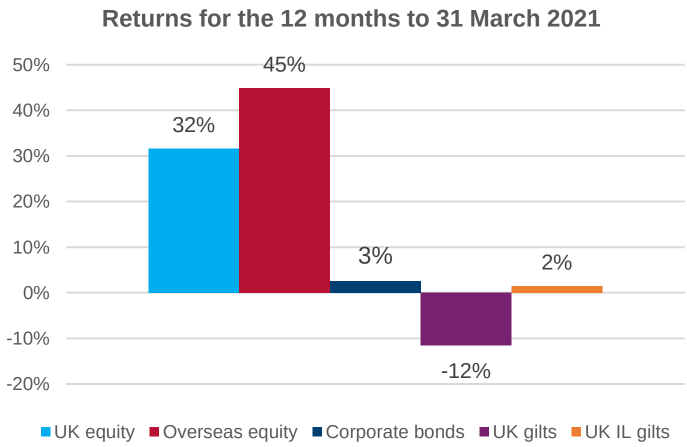
FRS 102 funding levels deteriorated over the year to 31 March 2021. Despite very different investment strategies, most types of scheme in our survey saw an aggregate funding level deterioration. The exception is single employer DB schemes ('own schemes') which saw an aggregate funding level improvement.

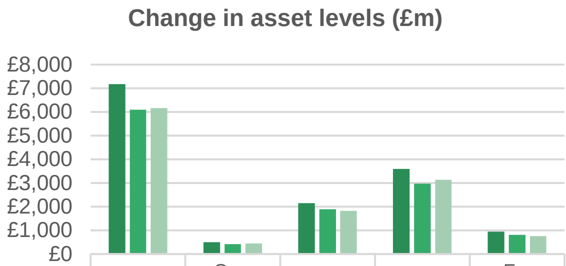
For SHPS, the aggregate FRS 102 funding level deteriorated over the year to 31 March 2021. This was caused by increased liabilities, resulting from a fall in discount rates and a rise in gilt market implied future inflation.



Assets

The aggregate asset value for the schemes included in our 2020 survey, i.e. the 189 results, increased by £1bn to £7.2bn. This is due to strong investment returns over the year as well as significant levels of contributions paid by employers.





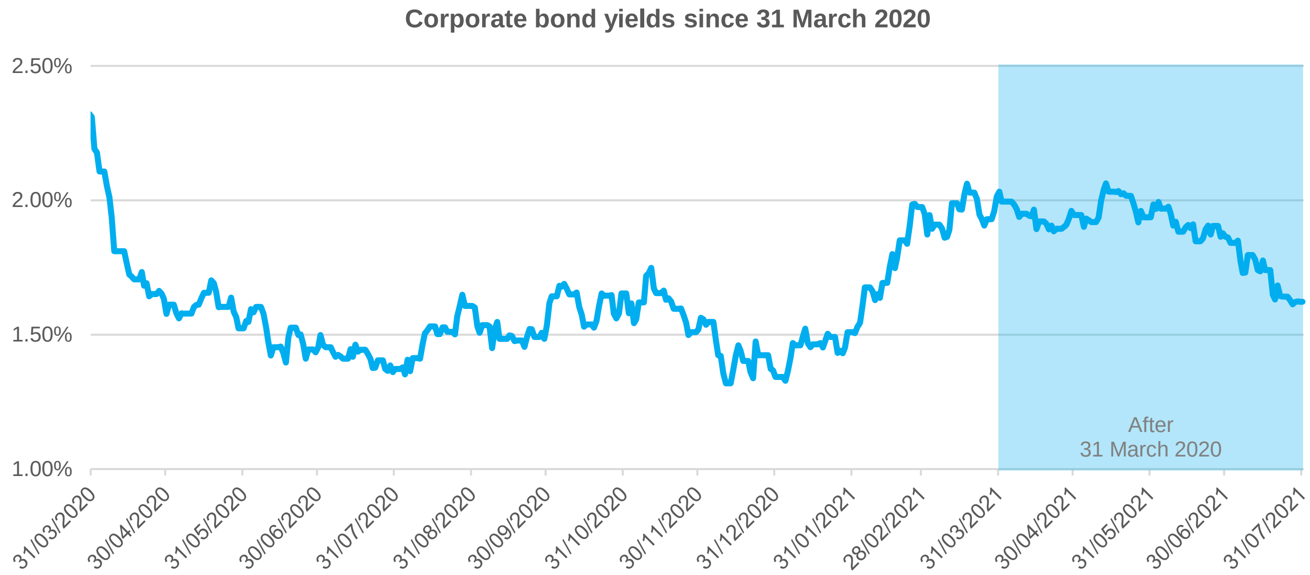
	Total	Own scheme	SHPS	LGPS	Ex-SHPS
2021	£7,180	£496	£2,145	£3,594	£946
2020	£6,098	£420	£1,886	£2,976	£816
2019	£6,156	£440	£1,822	£3,134	£760

2021 2020 2019

Following the huge financial shock in Q1 2020 from the impact of Covid-19, the value of ‘growth assets’ such as equities bounced back significantly. In the year to March, we saw continued strong performance in growth markets as well as price falls for (fixed interest) gilts. In this environment, pension schemes that hold a high proportion of equities (such as most LGPS funds) will have fared best.

Liabilities

The key assumption used to value the 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. The graph below shows that in terms of corporate bond yields, 31 March 2021 was a relatively favourable time to value FRS 102 pension liabilities compared to conditions before and after this date.



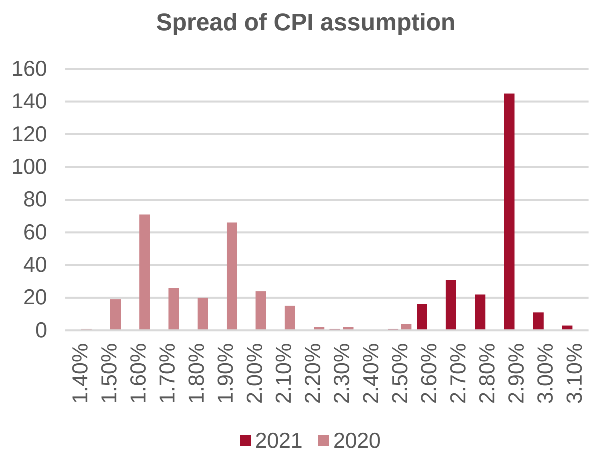
Although the discount rate is derived from the yield on high quality corporate bonds, there is a range of reasonable assumptions. The assumptions for FRS 102 are the responsibility of each association's board, and we are seeing an increasing trend towards receiving independent assumptions advice, rather than accepting the default assumptions provided by each scheme.

Even though different assumptions can sometimes be justified, the vast majority of results in our survey used a discount rate between 2.00% pa and 2.20% pa. This is in contrast to CPI inflation where the assumptions are spread over a greater range.

As there are no CPI market instruments, the CPI inflation assumption is derived by first setting a RPI inflation assumption based on the price of fixed and RPI index-linked gilts. A deduction is then made based on the RPI inflation assumption to obtain a CPI assumption. However, there is now a range of views on:

- whether gilt-market implied RPI inflation is a good indication of future RPI or needs to be adjusted
- the medium- and long-term gap between RPI and CPI.

CPI inflation assumptions in our survey typically ranged from 2.6% pa to 3.1% pa – a difference that could alter the value of the liabilities by 10% to 15%. The most common assumption was 2.9% pa (far above the Bank of England's 2% pa target).

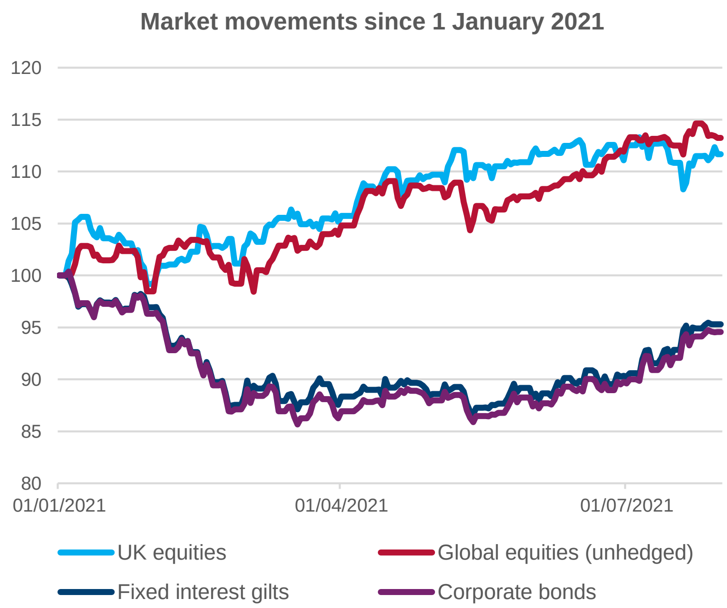


Developments since 31 March 2021

At the time of writing, global equities are up by around 10% since 31 March 2021. Other asset classes have also increased in value.

While the increase in asset prices is good news for pension scheme funding, there is bad news on the liability side. Corporate bond yields have fallen **by circa 40bps**, increasing the accounting liabilities in some schemes by up to 10%. In combination, the changes in asset and liability values since 31 March 2021 to late July 2021 will have resulted in a marginal rise in the FRS 102 funding levels for most schemes (with some schemes seeing an improvement of as much as circa 5%).

Financial market conditions remain extremely volatile and it is too early to make any predictions about funding levels at 31 March 2022.



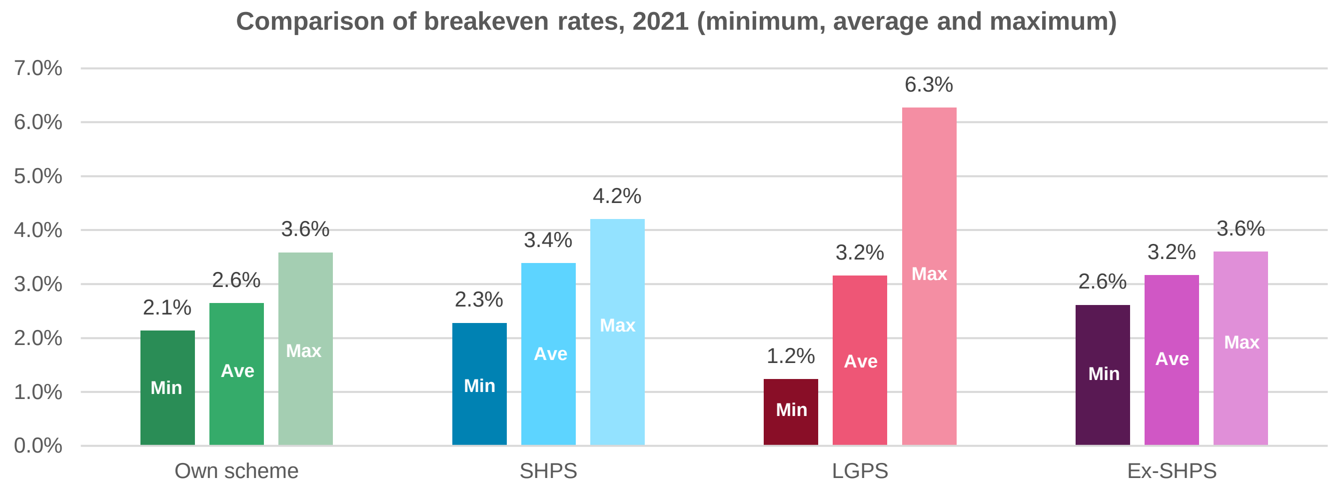
What does all this mean?

FRS 102 valuations provide interesting insights into pension scheme funding. However, they are not used to determine cash funding. For cash funding, the liabilities are valued on different (sometimes more prudent) assumptions and there are different (even more prudent) assumptions again for exit valuations.

The range of liability measures can get confusing. We often find it helpful to look at the issue the other way around – 'what investment returns do schemes need?' – rather than what return is being assumed in the liability calculation.

We call the investment return needed for the lifetime of the scheme in order to pay members their benefits in full the Break-Even Investment Return ('BEIR') (i.e. if this return was assumed in the liability calculation, there would be no funding deficit/surplus and no deficit contributions required).

The aggregate BEIR in our survey showed the funding of the sector's DB scheme liabilities is in a relatively healthy position – with a return of 3.2% pa needed over the schemes' lifetime to pay all accrued benefits. Arguably a return of 3.2% pa is still challenging in the current low interest rate environment (particularly if the investment strategy is cautious) and we therefore expect that employers in many schemes will still be asked for deficit contributions at upcoming actuarial valuations – as has just been announced for SHPS.



The graph above shows that funding and investment return needs vary considerably between schemes. To better understand your obligations and to benchmark your FRS 102 results against our survey, please get in touch.

Contact us to discuss this further

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