Medium Term Financial Strategy

2022/23 to 2024/25

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1. Foreword

1.1 Foreword to the Medium-Term Financial Strategy 2022/23 to 2024/25

1.1.1 This Medium-Term Financial Strategy (MTFS) has been produced by the South Yorkshire Pensions Authority to cover the period from April 2022 to March 2025. This period will see the continued emphasis on supporting the overall Corporate Strategy in building on the continuing improvement journey for the organisation, as well as continuing the transition of the Authority's remaining investment assets into the pooling structures provided by the Border to Coast Pensions Partnership.

1.1.2 The strategy covers both the costs of running the Authority's operations and the income and expenditure of the pension fund, although this is significantly more difficult to forecast than routine running costs such as staff salaries.

1.1.3 Any financial strategy is based on a series of key assumptions and throughout this document these assumptions are identified and are subject to ongoing review as part of the process of regular budget monitoring and producing updates to this strategy.

1.1.4 The financial strategy (and the budget which is the annual expression of the strategy) is, put simply, the financial expression of the policy position set out in the corporate strategy. Hence this strategy is updated each year as the Corporate Strategy is updated to reflect changed circumstances.

1.1.5 While SYPA is less exposed to the wider constraints on the public sector financial environment than our colleagues in the major employing organisations within the Pension Fund, we still have a responsibility to manage the resources for which we are responsible in such a way that our expenditure does not negatively impact on the overall performance of the Pension Fund. This strategy sets out how we aim to achieve this in as transparent a way as possible.

2. Setting the context for the medium term financial strategy

2.1 Public Sector Finance

2.1.1 The public sector financial environment is probably the most significant factor defining the context in which this strategy is developed. Key issues, like the level of pay awards, have an impact both on some aspects of the Fund's liabilities as well as upon elements of the Authority's cost base.

2.1.2 The main factors which normally affect the Authority and the Fund are concerned with local government finance. In general terms, growth in local government spending tends to lag growth in the generality of government spending, although pay tends to mirror the headline change in public sector pay.

2.1.3 The effects of the global COVID-19 pandemic and other demand pressures remain hugely significant issues for Local Government. The financial settlement includes funding for Councils for costs arising from this, as well as additional funding for social care. However, a substantial proportion of this additional funding is dependent on increases to council tax, and it remains the case that the overall context is that local government finances are under increasing pressure.

2.1.4 The national pay award for 2021/22 has yet to be agreed at time of writing in February 2022. The final offer from the employer side was 1.75%. This was rejected and the trade unions balloted their members for strike action, the results of which are currently awaited.

2.1.5 For the time being, our assessment of what this means for the Authority and the Fund is that it is likely that headline pay increases in the medium term will be at around, or quite possibly below, the level of 2%, and that major employers (and probably schools and colleges as well) will continue to need to identify significant year on year savings. This has wider effects on a number of areas, including the affordability of contribution rates, the balance of membership between active, deferred and pensioner members, and the number of early retirements on grounds of redundancy. These factors will influence the value of benefits in payment, the average lifetime in retirement and the value of lump sum "strain" payments into the Fund. All of these factors will need to be reflected in forecasts of income and expenditure and in the debate over contribution rates at each valuation.

2.2 The Pensions Sector

2.2.1 What is happening in the wider pensions sector impacts the Authority and the Fund in a less direct way, although no less significantly. For example, a significant change in the funding level of the remaining private sector defined benefit schemes could change the value of certain assets classes used to address the results of the change (e.g., a search for index linked gilts if funding levels increased). This could impact on the potential rate of growth in the value of the Fund or could make it harder to deploy capital into specific types of asset if other funds take up the supply of assets.

2.2.2 In addition, trends in the wider pensions sector tend, over time, to influence developments within LGPS and in the public sector pensions' space. These trends may arise from regulatory emphasis, such as the continuing focus on data quality, or from changes in technology such as the growing emphasis on various forms of e-communication, and methods of engaging with scheme members.

2.3 The Economic Environment

2.3.1 The wider economic environment impacts the Fund in terms of both its assets and its liabilities. Clearly the underlying economic environment impacts the performance of investments in the financial markets while key metrics such as inflation and interest rates feed into the actuarial calculations which determine the Fund's liabilities.

2.3.2 It remains incredibly difficult to forecast the movements in key economic indicators therefore it makes sense for this strategy to use assumptions based on key factors already reflected in the financial framework such as the assumed level of investment return included in the actuarial valuation. This is not a protection against any forecast being wrong – it almost certainly will be – but it means that the strategy is based on an underlying set of assumptions that have been subject to a more rigorous set of testing than it would be possible to achieve internally.

2.4 The Starting Point

2.4.1 The starting point has a significant impact on any strategy. In this case, the starting point is reflected in the current cost base for the Authority's operations and its fund management arrangements and the level of funding within the scheme which, based on the 2019 valuation results, reflects a significant improvement on the previous 2016 position.

2.4.2 In some senses the starting point is possibly more influential than other aspects of the context, for example achieving full funding, or close to full funding leads to an alteration to the strategic asset allocation moving funds out of equities into less volatile, preferably income generating assets. Unfortunately, these tend to be more expensive assets to manage thus a change in the cost base is almost inevitable. Whether the focus is on net of fees return or gross fees is irrelevant because both will ultimately have the same impact on the value of and performance of the Fund.

2.4.3 For the South Yorkshire Pension Fund, the starting point is, based on the 2019 valuation results, very close to full funding. This impacted employers' deficit recovery contributions, which in many cases were no longer required. This informed the review of the strategy and the production of the current Investment Strategy Statement from March 2020, which reduced the level of exposure to UK equities and index linked gilts and moved funds into private credit and infrastructure with the aim of reducing volatility and achieving additional stable income.

3. Financial objectives

3.1 Financial Objectives

3.1.1 For any strategy it is important to understand what you are aiming to achieve. This is no less true of this MTFS, and this section sets out objectives in relation to the control of costs in the overall context of the Fund. In order to set these objectives, we need to understand how SYPA's costs compare to the rest of the LGPS funds.

3.2 Comparative Costs

3.2.1 The only real source of data to compare SYPA with other LGPS funds is the annual SF3 return completed by all English and Welsh funds and submitted to MHCLG. Similar data for the Scottish and Northern Irish funds can be added to this from fund annual reports to give a UK wide comparison. There are flaws with this data, particularly regarding the disclosure of non-invoiced investment costs, which are gradually, but very slowly, being worked out of the system. However, it is the only comprehensive data set available and does give a broad indication of how SYPA compares with other LGPS funds.

3.2.2 Chart 1 below shows how SYPA's total costs compare with those of both the totality of other LGPS funds and of particular types of fund, for the last three financial years from 2018/19 to 2020/21.

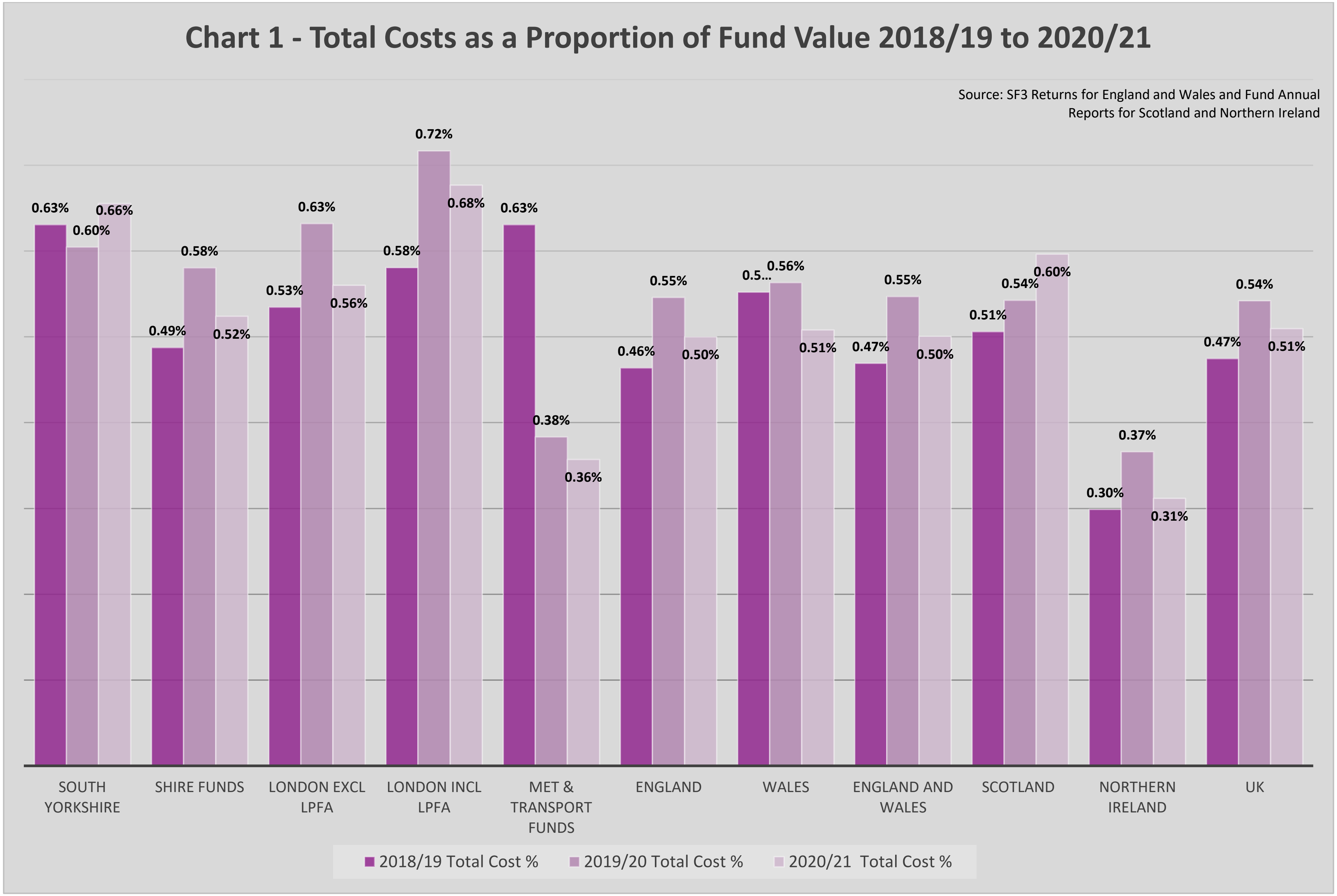
Chart 1 - Total Costs as a Proportion of Fund Value 2018/19 to 2020/21
Source: SF3 Returns for England and Wales and Fund Annual Reports for Scotland and Northern Ireland
0.63%
0.60%
0.66%
0.49%
0.58%
0.52%
0.53%
0.63%
0.56%
0.58%
0.72%
0.68%
0.63%
0.38%
0.36%
0.46%
0.55%
0.50%
0.5...
0.56%
0.51%
0.47%
0.55%
0.50%
0.51%
0.54%
0.60%
0.30%
0.37%
0.31%
0.47%
0.54%
0.51%
SOUTH YORKSHIRE
SHIRE FUNDS
LONDON EXCL LPFA
LONDON INCL LPFA
MET & TRANSPORT FUNDS
ENGLAND
WALES
ENGLAND AND WALES
SCOTLAND
NORTHERN IRELAND
UK
2018/19 Total Cost %
2019/20 Total Cost %
2020/21 Total Cost %

3.2.3 This appears to show that South Yorkshire's costs as a proportion of Fund value now represent one of the highest cost Funds in this comparison. However, it is important to note that the primary driver for this is investment costs and this should be considered in the context of the drive to greater cost transparency and improved reporting of investment management expenses that are not invoiced but deducted at source from Net Asset Value (NAV). Since 2018/19 SYPA, with the aid of Border to Coast, has made significant progress in this regard, that so far is outpacing the progress of other Funds. It should also be noted that unlike other LGPS funds, SYPA is not able to fully recover VAT resulting in a tax drag, which in 2020/21 amounted to £0.2m, and was c.£0.5m in the two years before that.

3.2.4 Whilst our progress on cost transparency appears to have started earlier and moved more quickly, it is evident that a similar impact is now starting to be seen within some of the other Funds' costs for 2019/20 to 2020/21; and it is anticipated this will continue, making these comparisons more useful going forward as they will be on a more 'like-for-like' basis.

3.2.5 The following table presents more detail of the investment costs and this demonstrates the impact since 2018/19 of the enhanced reporting of these external management costs that are deducted at source.

Investment Management Expenses - Breakdown	2018/19	2019/20	2020/21	Movement 2019/20 to 2020/21
	£000	£000	£000	£000
Pooling Costs - Invoiced	1,935	2,066	3,891	1,825
Internal Management Costs	672	596	539	(57)
External Management Costs - Invoiced	5,335	3,529	2,528	(1,001)
External Management Costs - Deducted at Source	40,254	37,790	52,431	14,641
Irrecoverable VAT Liability	516	497	211	(286)
Total Investment Management Expenses	**48,712**	**44,478**	**59,600**	**(4,234)**
Fund Value at 31 March: £000	**8,439,965**	**8,170,401**	**9,862,073**	**1,691,672**
Investment Costs as Percentage of Fund Value %	**0.58%**	**0.54%**	**0.60%**	

3.2.6 The Authority is confident that our performance in controlling actual costs overall remains strong; but there is no room for complacency, and we continue to closely monitor this area in light of the following factors that are driving cost increases:

- The Fund's strategic asset allocation is moving more of the portfolio into unlisted assets such as private equity and infrastructure which in general tend to be more expensive to manage.

- The Government's pooling initiative results in SYPA's listed assets in future being managed within pooled structures provided by Border to Coast which, while cheap in comparison to external managers, are more expensive than the previous, admittedly unsustainable, in-house arrangements.

3.2.7 There are specific factors which might be expected to give rise to SYPA having a higher-than-average cost base, in particular the fact that it is a stand-alone pension organisation bearing its own corporate overheads, rather than sharing them with a council. This has not been borne out by the data in recent years but will be kept under review as part of the budget process going forward, particularly as the Authority continues to invest in the development of the organisation and governance.

3.2.8 The total cost shown in Chart 1 can be analysed in more detail by looking at the following two charts which separate out SYPA's Investment and Administration costs and how these compare with the rest of the Local Government Pension Scheme across the UK.

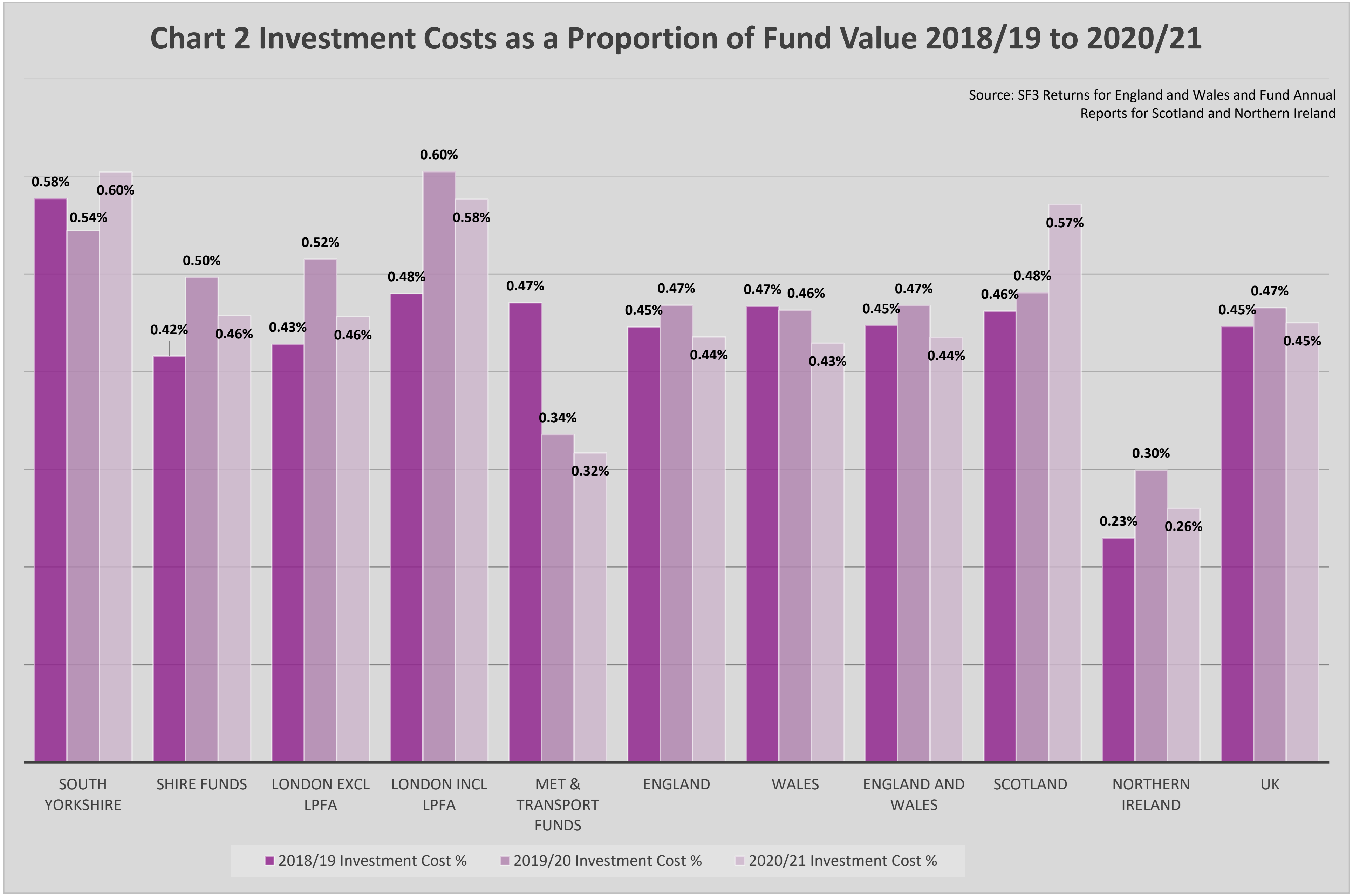
Chart 2 Investment Costs as a Proportion of Fund Value 2018/19 to 2020/21
Source: SF3 Returns for England and Wales and Fund Annual Reports for Scotland and Northern Ireland
0.58%
0.54%
0.60%
0.42%
0.50%
0.46%
0.43%
0.52%
0.46%
0.48%
0.60%
0.58%
0.47%
0.34%
0.32%
0.45%
0.47%
0.44%
0.47%
0.46%
0.43%
0.45%
0.47%
0.44%
0.46%
0.48%
0.57%
0.23%
0.30%
0.26%
0.45%
0.47%
0.45%
SOUTH YORKSHIRE
SHIRE FUNDS
LONDON EXCL LPFA
LONDON INCL LPFA
MET & TRANSPORT FUNDS
ENGLAND
WALES
ENGLAND AND WALES
SCOTLAND
NORTHERN IRELAND
UK
2018/19 Investment Cost %
2019/20 Investment Cost %
2020/21 Investment Cost %

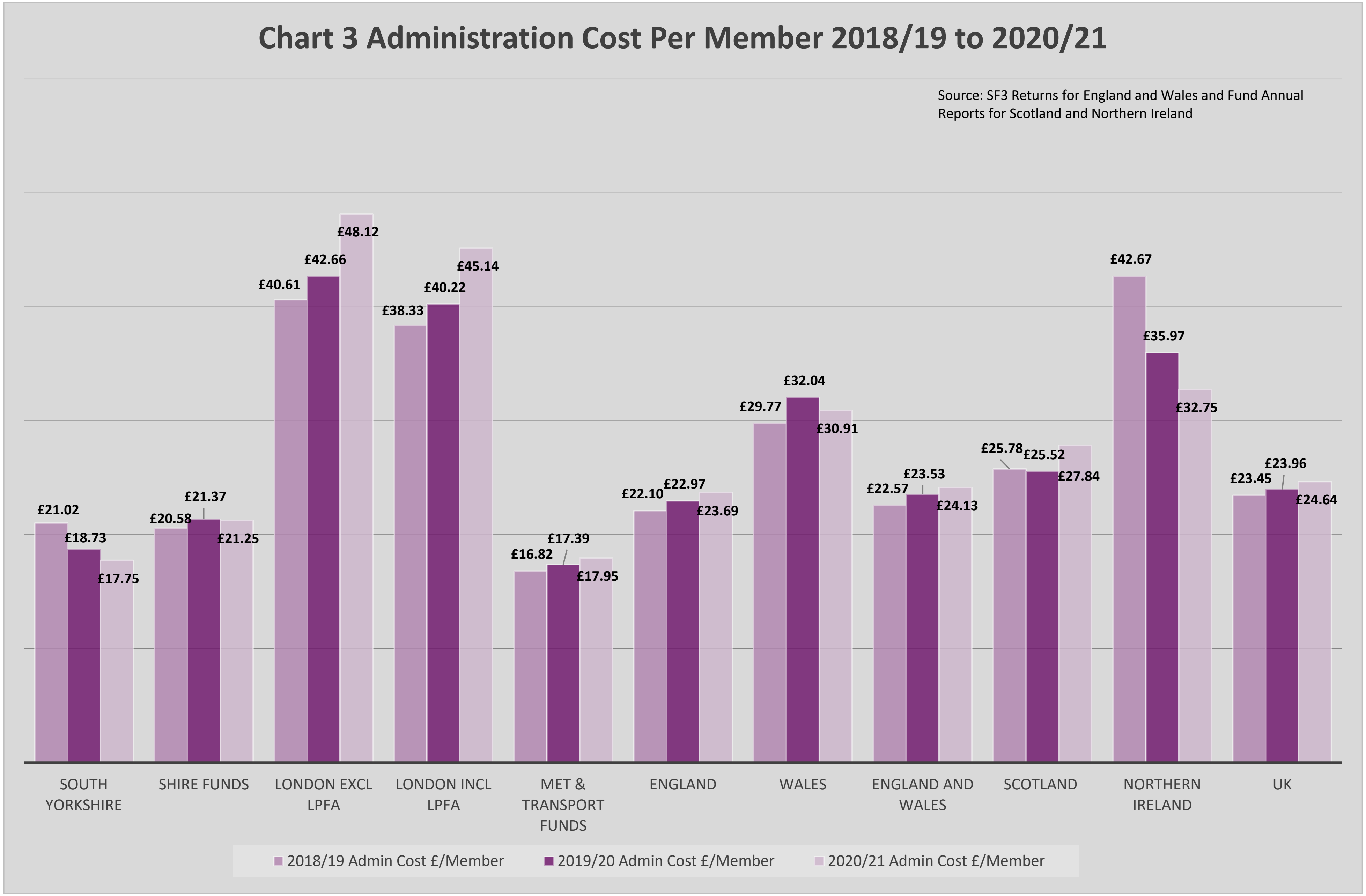
Chart 3 Administration Cost Per Member 2018/19 to 2020/21
Source: SF3 Returns for England and Wales and Fund Annual Reports for Scotland and Northern Ireland
£21.02
£18.73
£17.75
£20.58
£21.37
£21.25
£40.61
£42.66
£48.12
£38.33
£40.22
£45.14
£16.82
£17.39
£17.95
£22.10
£22.97
£23.69
£29.77
£32.04
£30.91
£22.57
£23.53
£24.13
£25.78
£25.52
£27.84
£42.67
£35.97
£32.75
£23.45
£23.96
£24.64
SOUTH YORKSHIRE
SHIRE FUNDS
LONDON EXCL LPFA
LONDON INCL LPFA
MET & TRANSPORT FUNDS
ENGLAND
WALES
ENGLAND AND WALES
SCOTLAND
NORTHERN IRELAND
UK
2018/19 Admin Cost £/Member
2019/20 Admin Cost £/Member
2020/21 Admin Cost £/Member

3.2.10 It is evident from Chart 3 that Administration costs for the Authority remain at the lower end of the spectrum of costs.

3.2.11 In regard to Administration, SYPA is benefitting from the economy of scale that comes from serving a large fund, while the much smaller London funds clearly see the diseconomies which arise from servicing much smaller funds.

3.2.12 It is important that we continue to monitor the cost base and comparing our costs with other pension funds is a useful tool to inform this. However, it is important to assess this in a holistic way by benchmarking not only the cost but also the quality-of-service provision. In order to support this, we are now participating in an additional benchmarking exercise for Pensions Administration provided by CEM, an independent provider with wider involvement in supporting the pensions sector outside of the LGPS. This form of benchmarking differs from the comparisons above, and the CIPFA benchmarking that we continue to use, in that it examines our performance from a scheme member perspective rather than focusing purely on cost. The results of these benchmarking exercises are reported to the Local Pensions Board and the Authority each year.

3.2.13 The Authority will continue to make use of benchmarking in order to inform an on-going assessment of how we are performing in relation to the achievement of value for money. The challenge is how to use this information to set some clear objectives which will assist the Authority in managing its cost base while continuing to facilitate investment in the continued development and improvement of services to scheme members.

3.3 Financial Objectives

3.3.1 The Authority needs to set financial objectives which focus on the key streams of activity within its operations, administration and investment while bringing these together to focus on total cost. These objectives will mirror the financial constraint imposed on the district councils by the grant system, thus ensuring that SYPA is taking no more from the pension fund for its running costs than is necessary.

3.3.2 At the same time the Authority must be careful, as a small organisation, not to "shoot itself in the foot" by setting unachievable financial objectives which generate relatively large-scale savings targets, which could not be delivered without impacting the customer experience.

3.3.3 For Pensions Administration, the financial objective may be framed as follows:

"The annual increase in the budgeted cost per member for administration functions will be limited to an index made up of 70% local government pay and 30% August CPI."

3.3.4 This limits the rate of increase in costs while allowing the benefits of any increase in productivity to be re-invested in the quality of the service provided to members, which is broadly in line with the Authority's overall objectives. Such an approach also provides some buoyancy in the level of resources available in order to address the rising number of members and employers within the Fund. A similarly expressed objective could be placed on the Authority's overall operating budget, which would place a helpful constraint on corporate costs. These two objectives are illustrated in the table below.

Cash Limits for Operating Budget	2022/23 Baseline £ / Member	2023/24 Cash Limit[2] £ / Member	2024/25 Cash Limit[2] £ / Member
Administration Service[1]	£23.35	£23.89	£24.44
Authority Operational Budget[1]	£34.36	£35.15	£35.96

Notes

1. The cost per member is based on the relevant totals included within the Authority's operational budget as presented for approval at the Authority's February 2022 meeting. The equivalent figures for SF3 reporting purposes will be slightly higher because they additionally include non-recoverable VAT which is not part of the Authority's total operating budget.

2. The future years' cash limits are calculated by applying an inflationary increase of 2.3% which comprises 2.0% Local Government Pay Inflation and 3.1% CPI Inflation, weighted in accordance with the financial objective set out above.

3. Membership is assumed to increase at 1.5% per year in line with recent trends.

3.3.5 Given that, broadly, investment costs have a relationship to the value of invested assets, it would be sensible to have an objective which recognises this, but also recognises the fact that the Authority's investment strategy is to move out of listed into unlisted and more expensive assets, and also that the Authority's overall objective is to achieve the best possible net of fees risk-adjusted returns meeting the actuarial return objective (currently c. 3.9%pa). This means that any financial objective around investment costs should not place an artificial constraint which prevents the Authority from making the right investment decisions.

3.3.6 Given the information set out above, framing an objective in relation to investment costs is quite difficult. However, something along the following lines could be appropriate:

"In any financial year, the Authority will seek to limit investment management expenses to a level less than the median in the CEM benchmarking comparator group."

3.3.7 Given the limitations to an LGPS comparator set out above this metric provides a more realistic target which is based on a much wider international peer group and reflects full cost transparency for all participants, thus there will be a like for like comparison. Using the CEM measure also means that the Authority will have access to data which will allow it to understand how and why its costs differ from others within the peer group.

3.3.8 The targets set out in these financial objectives will be reviewed each year in the context of their impact on the Authority's overall financial position and their impact on the ability of the Authority to deliver its corporate objectives, while still driving improvements in efficiency. In addition to these objectives which can easily be measured in budget setting and which in effect place cash limits on the Authority's budget, a number of financial performance measures related to comparative costs will be part of the suite of Corporate Strategy measures.

4. Financial forecasts

4.1 Forecast Assumptions

4.1.1 Any financial forecast is based on a series of assumptions. The key assumptions are set out below:

- **Pay –** Pay awards have been assumed to average 2% over the period, which is in line with the average of headline increases from the most recent local government pay awards.
- **Prices -** CPI inflation will be 3.1% for 2022/23 per the September 2021 CPI rate; and will be 2.4% over the remaining period in line with Actuary's assumptions for the 2019 valuation. This impacts a small portion of the operational budget but is a key driver for the cost of benefits in payment.
- **Contribution Income –** The forecast is based on the actuarial results of the 2019 Valuation for Future Service Rates and Deficit recovery payments that apply from April 2020 to March 2023 and takes account of the pattern of prepayments made by some of the larger employers in the scheme (in order to benefit from a reduction in the total to be paid over the 3-year period). The forecast for April 2023 to March 2025 is less certain pending the results of the 2022 triennial valuation becoming available but, in the absence of any better information at this time, is based on assuming a similar overall funding level and similar pattern of prepayments as resulted from the 2019 valuation.
- **Volume Driven Benefits and Transfers Costs/Income -** These are based on three year moving averages, adjusted where relevant for known large one-off items such as bulk transfers out.
- The assumptions in the operational budget forecast have been varied from the above for 2022/23 in relation to pay; where rather than including an assumed pay award on individual salaries, a separate corporate contingency has instead been introduced as explained in paragraph 4.2.5 below and in further detail in the annual budget report elsewhere on this agenda.
- Investment returns are assumed to be in line with actuarial assumptions.
- External investment management costs have been separately analysed in order to produce the forecast based on experience to date plus known changes and estimated changes as a result of continued transition to Pooling.

4.1.2 Based on current knowledge, these assumptions are reasonable. We will continue to develop and refine our forecasting techniques over the period to provide a robust basis for resource planning.

4.2 Operational Budget Forecast

4.2.1 The forecast for the operational budget is summarised in the table below:

Operating Budget	2021/22 Forecast Outturn £	2022/23 Budget £	2023/24 Estimate £	2024/25 Estimate £
Employees	3,371,680	3,862,320	3,922,720	4,000,700
Running Costs	1,748,470	2,155,530	1,950,010	1,983,720
Subtotal: Gross Expenditure	**5,120,150**	**6,017,850**	**5,872,730**	**5,984,420**
Income	(132,790)	(121,490)	(121,490)	(121,490)
Subtotal: Net Expenditure	**4,987,360**	**5,896,360**	**5,751,240**	**5,862,930**
Capital Expenditure	1,671,000	0	0	0
Contribution to / from Reserves	(1,212,760)	(66,360)	50,000	50,000
Total Charge to Pension Fund	**5,445,600**	**5,830,000**	**5,801,240**	**5,912,930**
Membership	168,000	169,680	172,230	174,810
Cost Per Member	**£32.41**	**£34.36**	**£33.68**	**£33.82**

4.2.2 The budget setting and medium-term financial strategy (MTFS) preparation for 2022/23 to 2024/25 has taken place in the context of a number of drivers for growth in cost that are explained in further detail in the Budget report presented alongside this Strategy. Having retained the budget at the same cash level throughout the period from 2019/20 to 2021/22 has allowed us to take the time necessary to examine all the resourcing requirements and clarify the base position before allowing for any budget growth. This aligns with the wider objectives of how the organisation is to be run and now that this work has been undertaken, we have a sound and clear basis to justify the increased budget requirement.

4.2.3 The budget for the 2022/23 year ahead reflects continued emphasis on equipping the organisation for meeting the challenges expected in the next three years as detailed in the Corporate Strategy elsewhere on the agenda. Additional resources are included for four new posts to be established to support various specific areas of the planned work. The budget also includes the impact of some significant savings that have been achieved following completion of previous corporate objectives in respect of business systems and procurement of a new contract for actuarial services.

4.2.4 The estimates for the remainder of the Medium Term set out above are based on projecting the 2022/23 budget forward, removing the one-off items from that year, and adding inflationary increases as necessary.

4.2.5 The key risks and uncertainties in relation to this forecast are as follows:

- Pay settlements and inflation running at a higher level than assumed in the forecast. This is clearly a risk, although the current wider local government and public sector finance context has been heavily impacted by the global pandemic and a range of pressures including social care demand, and the UK's exit from the EU. The forecasts used are prudent and reflect a broad consensus view. In the budget for 2022/23, we have also introduced a corporate contingency budget at c.5% of the pay budget with the aim of mitigating such risk. This is in addition to the usual process of budgetary control whereby in the event of higher costs than forecast, managers will seek to absorb the in-year impact through the management of vacancies and seeking to either defer one off expenditure or avoid aspects of running cost expenditure. It is considered that these measures will be adequate to address the risk of cost increases.

- Deterioration in budgetary control. Budgetary controls and processes were strengthened during the 2019/20 - 2020/21 period and are now well embedded. The implementation of the new finance system that has taken place in the final quarter of 2021/22 will enable officers to further refine and enhance the budgetary control, monitoring and reporting over the next financial year. There is therefore no indication of any likelihood of deterioration. The controls in this regard are also subject to internal audit review on a regular basis, which provides assurance on both their adequacy and their application.
- Loss of external income. This is mitigated through prudent budgeting, for example not including any assumptions around additional software sales which tend to be sporadic, and through securing longer term agreements with customers with staggered end dates so that not all agreements come to an end at the same time.

4.2.6 The operational budget is relatively low risk and is relatively simple in comparison to the Fund Forecast, being many times smaller and much less volatile. Consequently, while it understandably receives specific scrutiny as a cost that, in effect, has to be borne by participants in the Fund, variations are unlikely to have a material impact on the overall standing of the Fund.

4.3 Pension Fund Forecast

4.3.1 The table below presents a summary of the forecast for the Pension Fund for the current and coming three years.

South Yorkshire Pension Fund Financial Forecast	Actual 2020/21 £m	Forecast 2021/22 £m	Forecast 2022/23 £m	Forecast 2023/24 £m	Forecast 2024/25 £m
Dealings with members, employers and others directly involved in the scheme:					
Contributions receivable & transfers in from other pension funds	(304)	(200)	(300)	(315)	(216)
Benefits payable and payments to or on account of leavers	331	343	354	362	371
Net (additions) / withdrawals from dealings with members	**27**	**143**	**54**	**47**	**155**
Management expenses	65	70	77	84	92
Net returns on investments	(1,784)	(943)	(544)	(561)	(693)
Net (increase)/decrease in the Fund during the year	**(1,692)**	**(730)**	**(413)**	**(430)**	**(446)**
Net Assets of the Fund at 1 April	(8,170)	(9,862)	(10,592)	(11,005)	(11,435)
Net Assets of the Fund at 31 March	**(9,862)**	**(10,592)**	**(11,005)**	**(11,435)**	**(11,881)**
Management Expenses as Percentage of Average Net Assets	0.72%	0.68%	0.71%	0.75%	0.79%

4.3.2 In the first year of the forecast, investment costs (including those within the operational budget) are at 68 bps and are expected to rise up to 79 bps by 2024/25. However, this forecast does not fully reflect change in costs which will arise from the pooling process, which will to some extent mitigate these increases. It should also be borne in mind that this forecast is produced on a fully transparent basis and therefore comparisons with other funds will not necessarily be valid. These forecasts will be reviewed against benchmark data when available.

4.3.3 The forecast for the Pension Fund is much more susceptible to forecast error than that for the operational budget. In particular, while there is some consistency in terms of data from previous years the Authority cannot control the numbers of members retiring in any year or the decisions which they make in relation to commutation of pension to lump sum. Similarly, the numbers of deaths amongst the membership of the Fund and the numbers of members transferring either into or out of the Fund are changeable and outside the control of the Authority. While the forecasts are based on the best information available using both actuarial results and historic information as adjusted for known one off events and inflation where appropriate, there is a significant amount of variability from year to year which it is extremely difficult to forecast.

4.3.4 The forecast Fund value at the end of the current year reflects the strong investment performance seen so far this year.

4.3.5 The important message in the above forecast is the anticipated net withdrawal from the Fund in each year for dealings with members, this results in a significant increase in the requirement for the harvesting of investment income.

4.3.6 The key risks and uncertainties in the Fund Forecast include the following:

- Financial market volatility, which will impact on both the asset value of the Fund and on the level of investment income and large swings in asset value will result in significant variation from the forecast. This is a constant risk for pension funds. Steps have been taken, both through the broad asset allocation and through the equity protection that was in place up until April 2020, to reduce the potential volatility in the Fund but the risk of events which might cause significant market dislocation remains and, if anything, is at the current time heightened as a result of continuing tensions around international trade and the economic impact of the COVID-19 pandemic.
- A further significant wave of service reductions across major employers resulting in workforce reductions which have the effect of reducing the number of active members contributing and further increase the imbalance between contributions received and benefits paid. Other than changes in the Strategic Asset Allocation to focus on income generation and delivering investment returns above actuarial assumptions to build resilience into the Fund, there are limited options available to the Fund in this area, although structuring contribution cash flows may provide some further assistance in dealing with the issue.
- Failure of pooling to contain investment costs. While SYPA is not expecting to make any significant savings as a result of pooling, in the short to medium term the expectation is that the process of pooling will contain costs. However, should the Pool fail to achieve its objectives in this area there will be an impact on net of fees returns. To date, the evidence is that in this respect Border to Coast are delivering in line with their plan and, should the initial moves of partner funds into the range of internally managed funds continue or increase, there may well be the opportunity for costs in relation to listed assets to reduce towards the pre-pooling levels, although they are very unlikely to reach those artificially low levels. If the Pool were to fail to deliver cost savings as anticipated, then further mitigation will come through the collective action of the 11 partner funds to address any underperformance.

4.3.7 This forward forecast indicates a challenging position when viewed in the context of market conditions and uncertainty as at the time of writing. All economic forecasts indicate that we are moving into a significantly lower return and potentially higher inflation environment for a protracted period which is reflected in the actuarial assumptions used in producing the forecast. This results in the need for the Fund and the Pool to focus on securing good assets and sustained income streams within its revised strategic asset allocation.

5. Policy on reserves

5.1 Reserves

5.1.1 Reserves are funds that are set aside for two main reasons:

- A 'just in case' risk materialises that requires additional resources; or
- To save up for a particular project.

5.1.2 All of SYPA's costs are met by the Pension Fund therefore, unlike a local authority, the first contingency argument for holding reserves does not hold as costs incurred, for example, as a result of a building fire, would simply fall to the Pension Fund which is about 1,800 times the size of the Authority's budget and such costs are therefore unlikely to be material.

5.1.3 The argument for holding reserves to save up for things does, though hold. In order to save up in this way, managers will have had to underspend their budgets and thus the ability to use money thus saved acts as an incentive to manage within the available resources.

5.1.4 However, there is a balance to be struck as reserves could be allowed to accumulate to a level where they became significant in the context of the Authority's budget at which point, they would in effect be depriving the Fund of cash to invest. Consequently, some limitation on the level of reserves is necessary to maintain this balance. The Authority therefore have the following policy in relation to reserves:

"The Authority will maintain its operational revenue reserves at a level equivalent to no more than 7.5% of its operational budget, the establishment of new reserves will be approved by the Authority on the recommendation of the Treasurer, and the level of reserves will be reviewed by the Treasurer each year as part of his report on the final accounts of the Authority."

5.1.5 During the 2019/20 and 2020/21 financial years, there were some large underspends against the budget (for various reasons that were explained more fully in the quarterly corporate performance reports) and a decision was taken, with the Authority's approval, to set aside these unused funds specifically for use towards financing major capital projects that needed to be resourced, primarily in the current 2021/22 year. These projects included the Oakwell House long-term office accommodation project, replacement of business systems and the implementation of a new contract for pensions administration software.

5.1.6 In order to achieve this, a new 'Capital Projects Reserve' was created following Authority approval in 2019/20. This reserve is not subject to the limit as set out above as this would not be appropriate given the nature of this reserve and the requirements to be funded. Nevertheless, the funding level contained in this reserve will be kept under review moving forward.

5.1.7 At the current time it is forecast that from 2022/23, this reserve will be used for setting aside funds each year as a way of saving towards the required amount that will be needed for the ICT hardware renewal and replacements programme, following the significant investment in laptops and associated equipment in 2020.

5.1.8 The forecast level of reserves for the medium term are as shown in the following table.

South Yorkshire Pensions Authority **Earmarked Reserves**	**Forecast Balance 31 March 2022** **£**	**Forecast Balance 31 March 2023** **£**	**Forecast Balance 31 March 2024** **£**	**Forecast Balance 31 March 2025** **£**
Operational Revenue Reserves:				
Corporate Strategy Reserve	220,210	187,190	199,190	211,190
ICT Development Reserve	178,300	109,960	112,960	115,960
Subtotal - Revenue Reserves	**398,510**	**297,150**	**312,150**	**327,150**
Revenue Reserves as % of Budget	*7.30%*	*5.10%*	*5.40%*	*5.50%*
Capital Projects Reserve	44,000	79,000	114,000	149,000
Total Reserves	**442,510**	**376,150**	**426,150**	**476,150**

5.1.9 The above table illustrates that the current plans and forecasts involve drawing down from the revenue reserves in 2022/23, followed by a net contribution into the reserves in the remaining period. The earmarked reserves will continue to be kept under review and transfers to and from each reserve will be reported to the Authority for approval based on a recommendation from the Treasurer as required, through the quarterly reporting of management accounts and financial forecasts.