Bracknell
Forest Homes

Private & Confidential

Kevin Taylor
Deputy Pension Fund Manager
Royal County of Berkshire Pension Fund
Minster Court
22-30 York Road
Maidenhead
Berkshire

By e mail and post: kevin.taylor@rbwm.gov.uk

27 April 2018

Dear Kevin,

Participation in the Royal County of Berkshire Pension Fund

As you are aware Bracknell Forest Homes' (**BFH**) is an admitted employer in the Royal County of Berkshire Pension Fund (**the Fund**). As you are also probably aware BFH is a registered provider of housing subject to regulation by the Regulator of Social Housing (previously known as the Homes and Communities Agency). BFH became admitted to the Fund following its creation connected to a large-scale transfer of social housing stock. Under the terms of the legal agreements entered into, BFH was required to offer continued membership of the Fund to the former council employees who transferred with the housing stock.

With a diminishing number of active members, the uncertainty of when BFH's liability to the Fund will crystallise and become payable is a key financial risk and one that BFH wishes to manage.

As such, BFH would like to propose that a Funding Agreement is put in place which will enable the accrued and on-going liability to be appropriately managed in a way that is of material benefit to both BFH and, we believe, the Fund.

BFH has been advised by its solicitors, Devonshires, that the Proposal that we wish to make complies with Regulation 64 of the Local Government Pension Scheme Regulation 2013 (**LGPS Regulations**) and the LGPS Regulations generally. Devonshires have also advised that other LGPS funds have agreed similar arrangements with other housing associations. We understand that at least one other housing association already has a form of Funding Agreement with the Fund.

Proposal

BFH understand from its solicitors that ordinarily the approach of the Fund is that, on the date the last active member leaves, the liabilities and obligations of BFH would crystallise under Regulation 64 of the LGPS Regulations and be payable.

If BFHs' liabilities crystallise, whether or not an agreement is then reached with the Fund to pay this debt in instalments over a period of time, in accounting terms this is treated as a debt in the same way as if the amount was paid immediately in full. Obviously this will have a material impact on the social investment that BFH could otherwise undertake.

BFH would like to propose a mechanism which enables its liability to be settled over a period of time but without this being treated as crystallised when the last active member leaves. The advantage to BFH of doing this is that, in accounting terms, the liability will not be treated as crystallising and as such will not affect its ability to invest in the communities in which it operates. The advantage to the Fund is that the on-going funding risk remains with BFH.

What we would like to agree with the Fund is a Funding Agreement, a draft form of which is attached at Appendix A. This is a draft and of course can be subject to amendment following discussion with the Fund if required. In summary, the draft agreement provides:

- On the date that BFH ceases to have active members it will exit the Fund (under Regulation 64 of the LGPS Regulations) and an actuarial valuation will be undertaken.
- Instead of the debt crystallising and being paid as at the date of exit, the rates and adjustment certificate issued by the Fund would certify that the liability will be that payable under the terms of the Funding Agreement.
- BFH's liability would remain as a floating liability.
- Under the Funding Agreement, BFH will pay in lump sum employer contributions assessed on an on-going funding basis until such time as the Funding Agreement terminates.
- To protect the Fund, the Funding Agreement can set out various Risk Events that, if triggered, could give grounds for the Fund to terminate the Funding Agreement. We have suggested appropriate provisions. These can be discussed and agreed.

- On termination of the Funding Agreement, the Fund will obtain a valuation on the termination valuation basis at that time and the debt certified under the rates and adjustment certificate will be payable.

I would be grateful if you could confirm whether or not the Fund is prepared to enter into an agreement in the form attached or similar?

I anticipate that this will need to be passed to your legal department and if they have any queries I would ask that they contact our solicitors whose details are as follows:

Kirsty Thompson
Devonshires Solicitors LLP
Email: kirsty.thompson@devonshires.co.uk
Tel: 020 7065 1847

I look forward to hearing from you.

Yours sincerely,

Martin Huckerby

Interim Executive Director – Finance
Bracknell Forest Homes

Cc Valerie Burns - Head of HR
Kirsty Thompson – Devonshires
Neal Thompson – First Actuarial

Devonshires
solicitors

Strictly Private and Confidential
Kevin Taylor
The Royal County of Berkshire Pension Fund

Our Ref: RCT/MDH1.38.

By email to: Kevin.taylor@rbwm.gov.uk

13 February 2018

Dear Kevin

Housing Solutions Limited: Participation in the Berkshire Pension Fund

I write in reference to the above matter. I act on behalf of Housing Solutions, which is admitted to the Berkshire Pension Fund ('**the Fund'**). I am authorised to write to you on my client's behalf and as you will see they are copied in to this letter.

Purpose of this letter

I have been instructed to write to you in relation to a proposal my client wishes to discuss with the Fund. Once you have had an opportunity to consider this letter it may be useful to arrange an early telephone conference or meeting to discuss this further.

Before setting out the proposal I thought it would be useful to set out the background to Housing Solutions' admission to the Fund.

Relevant background to the proposal

Housing Solutions (then called Maidenhead & District Housing Association Limited) was admitted to the Fund following a stock transfer from the Royal Borough of Windsor & Maidenhead in or around May 1995. In order for the transferring employees to continue participating in the Fund, HS was required to enter into an Admission Agreement with the Fund. This was entered into on 2 May 1995.

On or around 1 April 2001, there was a further transfer of staff to HS and a further Admission Agreement was entered into in respect of those transferring employees.

Housing Solutions now has approximately 61 active members remaining in the Fund under both Admission Agreements (11 active members under the 1995 Agreement and 50 active members in the 2001 Agreement).

Housing Solutions has recently carried out a review of its pensions offering to staff and is considering a number of options due to the increasing cost of defined benefit pensions, the unpredictability and uncertainty they bring, and issues of fairness and equity in relation to the different pension offers in place within the organisation. One of the options being considered is to commence consultation with its staff on a proposal to close its defined benefit schemes to future accrual for existing members and to move all employees on to a defined contribution arrangement. Around 70 employees are members of the defined contribution scheme following the closure of the defined benefit scheme to new entrants in 2014.

The proposal

I have been instructed to approach you in relation to the principle of the Fund entering into a legal agreement with Housing Solutions (which is referred to in this letter as a 'Funding Agreement') under which both its Admission Agreements can continue to operate when its last active member leaves the Fund. This is a principle that we have agreed with a number of other LGPS Funds on behalf of other housing association clients.

In seeking the agreement of the Fund to this proposal it is important to note Housing Solutions is <u>not</u> seeking to avoid its liabilities to the Fund; rather it is seeking to settle these, but in a way that does not create an immediate accounting issue when their last active member leaves and which could have material adverse implications for the service it provides within Berkshire.

In summary, the terms of a Funding Agreement would generally provide:

- What will happen when there are active members and when there are not.

- Whilst Housing Solutions has active members, that its liability will continue to be assessed on the on-going funding basis applicable to scheduled employers.

- On the date that Housing Solutions ceases to have active members that it will be treated as exiting the Fund (under Regulation 64 Local Government Pension Scheme Regulations 2013 ('**the Regulations**')

- Instead of the debt crystallising and being paid as at the date of exit, the Fund agrees that the rates and adjustment certificate will certify that the liability will be that payable under the terms of the Funding Agreement.

- That the Admission Agreement will continue notwithstanding active membership ceasing and Housing Solutions will continue to be treated as if it had remained in the Fund (i.e. its liability will remain uncrystallised and future contributions will continue to be assessed on an on-going funding basis until such time as the Funding Agreement terminates).

- Housing Solutions would aim to pay off the funding deficit by the end of its current recovery period. More importantly, Housing Solutions liability for future deficit contributions would not cease at the end of the recovery period. Like any other employer in the Fund, Housing Solutions would remain liable for any future deficits that emerge under its Admission Agreement, for example due to experience not being in line with the actuarial assumptions, or the assumptions themselves being updated at subsequent triennial valuations.

- To protect the Fund, the Funding Agreement can set out various conditions that Housing Solutions must comply with. These can be discussed and agreed. In the event that any of these conditions are breached, the Funding Agreement will terminate.

- In such circumstances if there are no active members, there will be a valuation on the termination valuation basis and the debt certified under the rates and adjustment certificate will be payable.

- The Funding Agreement can also provide for other provisions as to when it can be terminated (other than for default), for example if the value of the liability assessed on a termination valuation basis is less than a specified amount, say £100,000

The effect of the above proposal is that Regulation 64 of the Regulations would be complied with. We are of the view that it enables a lawful mechanism whereby the liability of Housing Solutions remains an uncrystallised liability and is paid over time (and reassessed on each triennial valuation). The benefit to my client is that their liability does not (other than on termination of the Funding Agreement) crystallise and become immediately payable.

This is a principle that a number of other LGPS Funds have agreed and I have negotiated and agreed similar forms of Funding Agreements for a number of clients with the Surrey LGPS Fund, the Buckinghamshire LGPS Fund, the LPFA, the Devon LGPS Fund and the Staffordshire LGPS Fund.

Merits of the proposal

We believe that our proposal merits your consideration for three main reasons:

- The proposal is equitable when you consider that when the Admission Agreements with HS were first set up, HS was notionally credited with assets equal to the value of the past-service liabilities measured using the ongoing funding assumptions, so that the HS section was 'fully funded' on those assumptions. It therefore seems illogical and unfair that the assumptions used for leaving the Fund should be different – if the HS section had ceased accrual on day two, would a deficit in relation to all of the employees' past service have been instantaneously created despite the HS section being fully funded one day earlier?

- HS is a not-for-profit organisation and so requiring it to pay out a large cash sum may impact on its primary purpose, which is delivering excellent services and high quality homes (both new homes and improvements to existing properties) to existing and future residents across Berkshire. In particular, this is not about HS not being able to make the cessation deficit payment – it's more to do with how that money could be better spent for the good of the community and meeting its core business objectives.

- It is better for the Fund and other participating employers to have a strong employer to continue its support and participation for the long-term, in order to meet the benefit promises of its former employees. In particular, it is worth noting that the Fund receiving the cessation deficit as a cash lump sum would not automatically ensure that there will be sufficient assets to meet the benefits at all points in the future. This means that there is a chance that HS's liability could fall back to the other participating employers in the Fund. This outcome would, of course, be avoided under our proposed approach as described above (until such time as a cessation event does actually take place).

We believe that the ongoing covenant provided to the Fund by HS is robust and will actually improve under the proposed approach as a potentially significant source of investment is not diverted away from HS's core business. Further details of our covenant are set out in the Appendix.

Impact if the proposal is not implemented

Unless otherwise agreed, and as we have set out above, on the date that HS ceases to have active members admitted to the Fund, then the Fund is likely to treat it as exiting the Fund. Under the Regulations, an exit valuation will be undertaken and the liability assessed will be reflected in the rates and adjustment certificate that is issued. The amount certified in this certificate will be a debt. As such, whether or not agreement is then reached with the Fund to pay this debt in instalments over a number of years, the entire amount will be treated as expenditure in the income and expenditure account of HS in that year. Dependent upon market conditions on the actual date of termination, and the actuarial assumptions and valuation basis applied by the scheme actuary, the actual level of cessation debt can vary substantially, month to month and day to day.

Whether or not the Fund requires the crystallised liability to be paid immediately as one lump sum it will in any event be a debt, which has an adverse accounting impact. As such, there may be an impact on the level of investment that can be made by my client, and subject to the level of debt there could, at least in theory, be a need to dispose of housing stock to satisfy that liability.

The effect of the proposal we have suggested is that the liability will remain as an uncrystallised liability; as such HS will remain liable and responsible for the liabilities in respect of their members which will be reassessed from time to time. Until such time as the Funding Agreement ends there is no liability which crystallises and which is shown as a debt in the income and expenditure account of HS. Entering into such an agreement would mitigate the risk of my client's liability to the Fund crystallising in the short term, and on a date over which they have no control.

We believe that it is possible to secure via a legal agreement terms which protect the Fund and which enable HS to manage, but not avoid, its liability to the Fund. This in turn will enable the social investment/development programme of HS not to be materially adversely impacted by the crystallisation of a pension debt that could be managed in a more advantageous way.

I would be grateful if you could consider the above and contact me to discuss this further and, if necessary, arrange an early meeting. If you are agreeable in principle to the above terms, we can provide you with a draft form of Funding Agreement for your consideration.

Yours sincerely

Ronnie Tong
Partner
Direct tel: 020 7880 4335
Direct fax: 020 7880 4226
E-mail: ronnie.tong@devonshires.co.uk

cc: Carol Lovell, Corporate Services Director, Housing Solutions
Andrew Robertson, Finance Director, Housing Solutions

Appendix

Strength of covenant

This Appendix sets out our view of the strength of the covenant that Housing Solutions offers to the Fund.

Housing Solutions has met all of its financial commitments in relation to its section of the Fund and fully intends to do so going forward. We understand that when assessing the sponsor covenant the Fund is expected to consider the employer's financial position and prospects, as well as its willingness to fund its pension obligations. Regarding the latter, Housing Solutions has always paid the required contributions when they were due and has developed a good working relationship with the Administering Authority. The proposed approach will not affect this in this regard; the Fund will continue to be supported in just the same way.

In terms of Housing Solutions' financial position and prospects, based on the latest audited accounts, Housing Solutions is financially strong and a very successful housing association. As the accounts indicate, HS has generated a significant surplus in each of the last eight years.

In addition, HS owns and manages or maintains just over 7,500 homes. With assets of £519 million, an annual turnover of £45m and reserves totalling £192 million, HS is a strong regional housing association.

Housing Solutions' net assets, after deducting the debt, are therefore expected to be considerably larger than any potential termination deficit.

Also, Housing Solutions complies comfortably with its existing loan covenants and is forecast to do so in the future. Relevant financial metrics are monitored and reported to lenders on a quarterly basis which should also provide assurance to the Fund regarding Housing Solutions ongoing financial health and the strength of the employer covenant. Housing Solutions is currently rated [A+] by Standard and Poors.

The Fund should gain further comfort with respect to the covenant from the fact that Housing Solutions' activities are regulated, and its statutory regulator, Homes England (previously the Homes and Communities Agency) monitors Housing Solutions to ensure that it meets Homes England's expectations in respect of financial viability and governance covenants. Housing Solutions is currently ranked G1 and V1, which are the top available ratings for governance and viability.

The above information confirms that Housing Solutions is a very strong employer, that provides a strong covenant to the Fund, and the expectation is that this will continue into the future.