Housing briefing, December 2022
FRS 102 survey

This briefing sets out the findings from our third annual survey, which looks at FRS 102 results and assumptions as at 31 March 2022 for the social housing sector. Our survey covers 234 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 31 March 2022

The aggregate FRS 102 funding level increased from **81%** as at 31 March 2021 to **90%** as at 31 March 2022.

Ex-SHPS schemes in the survey (created after a bulk transfer) retained a higher aggregate funding level than SHPS.

The aggregate asset value – for results covered in our survey – increased from **£6.9bn** as at 31 March 2021 to **£7.4bn** as at 31 March 2022.

Accounting liabilities decreased by **3%** over the year. In 2022, the range of reasonable assumptions can change the value of the liabilities by up to **15%.**

Major changes in the bond markets

The big story since 31 March 2022 has been the rise in gilt and bond yields.

For most DB schemes this is good news – rising yields mean falling liability values and increasing funding levels. However, the impact will be scheme-specific and will depend on the extent to which the scheme has already hedged yield movements.

The impact of rising yields is covered in more detail in our recent employer briefing and housing briefings.

In summary, we strongly recommend that sponsors get up-to-date estimates of funding positions (on different valuation measures) and consider what this means for their investment strategy and contributions.

In some cases, sponsors will have the 'nice-to-have' problem of considering how to handle funding surpluses!

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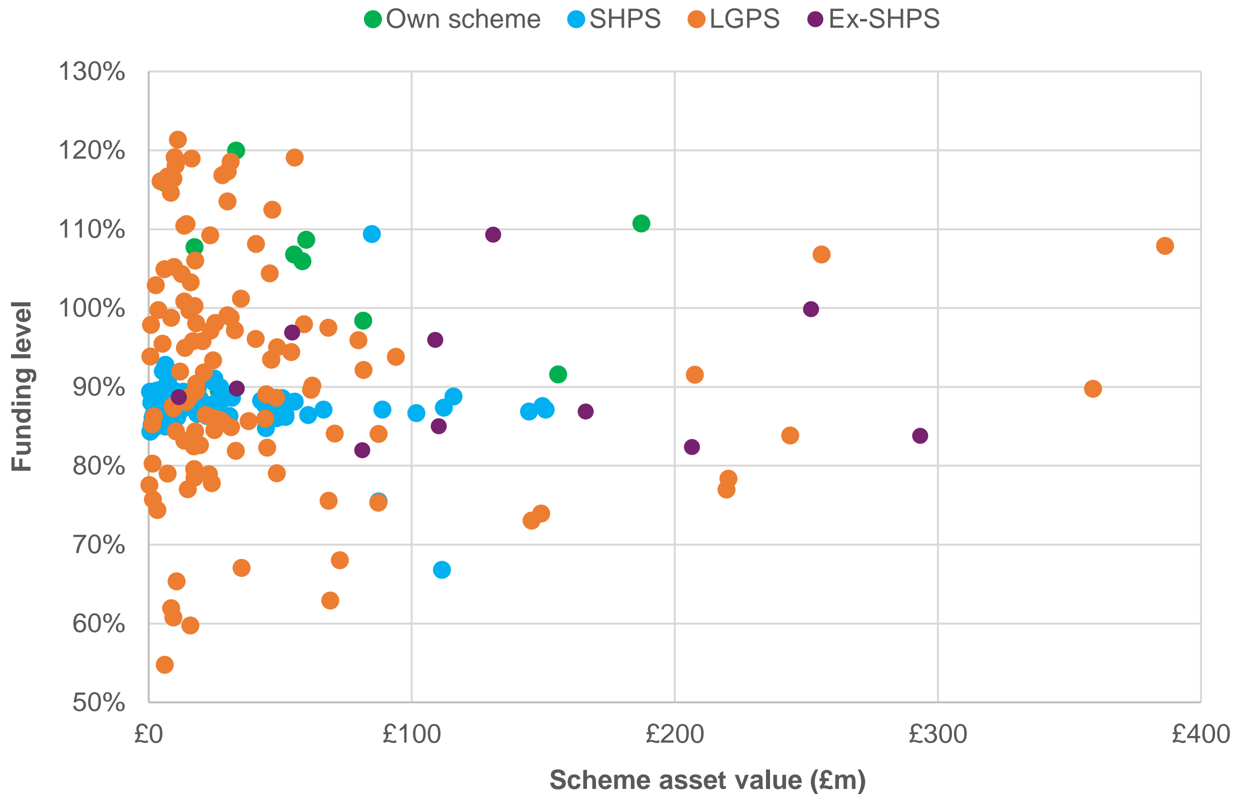
Funding levels

There continues to be a broad range of DB scheme funding levels across the sector.



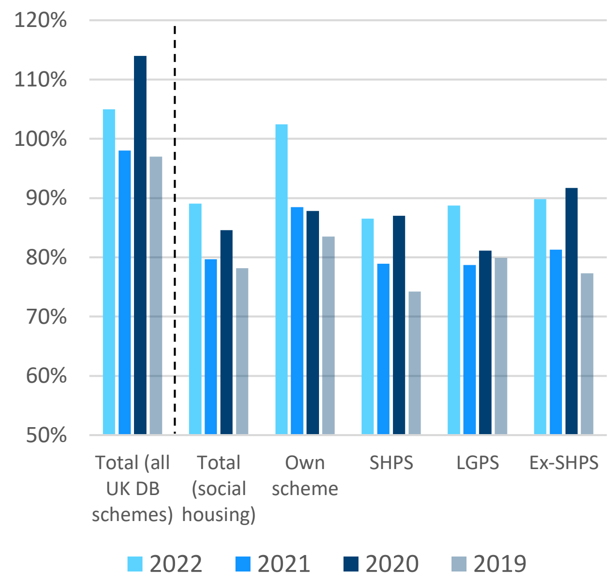
Funding levels

FRS 102 funding levels improved over the year to 31 March 2022 for all scheme categories (despite very different investment strategies).

For SHPS, the aggregate FRS 102 funding level improved over the year to 31 March 2022. This was caused by an increase in assets and a decrease in liabilities, resulting from an increase in discount rates which more than offset increases in expectations for future inflation.

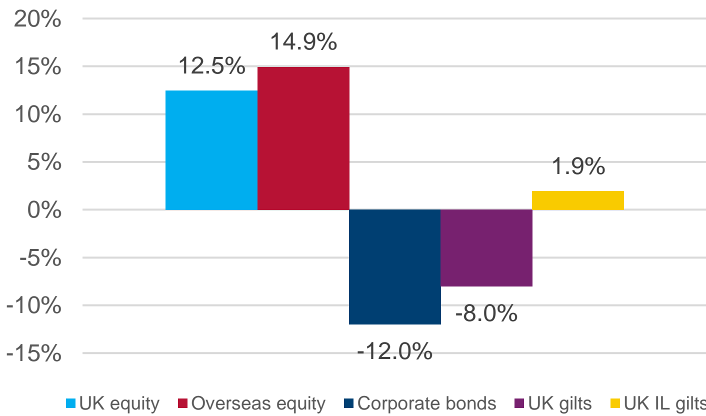
The aggregate funding level for LGPS funds covered in our survey increased from 79% to 89%. LGPS funds tend to invest in a way that provides little hedging against bond and gilt yields. Therefore, at the time of writing, we are expecting a big improvement in LGPS funding (on an accounting basis) as at 31 March 2023.

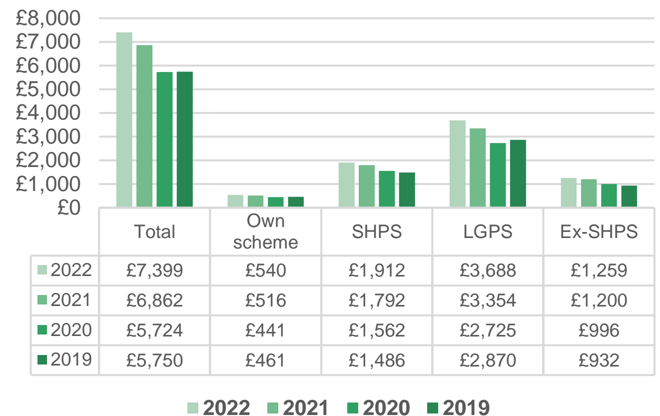
Despite the significant improvement in funding levels, the sector is still less well funded compared to the equivalent position of UK DB schemes overall.



Assets

The aggregate asset value for the schemes included in our past three surveys (2019, 2020 and 2021), i.e. the 173 results, increased by £0.5bn to £7.4bn. This is due to strong investment returns over the year to 31 March 2022, as well as significant levels of employer contributions.





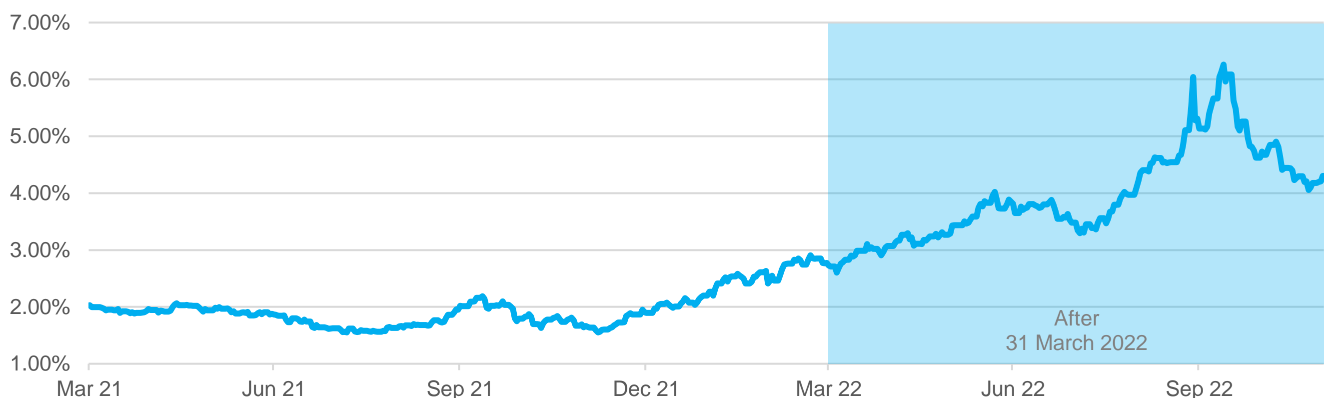
	Total	Own scheme	SHPS	LGPS	Ex-SHPS
2022	£7,399	£540	£1,912	£3,688	£1,259
2021	£6,862	£516	£1,792	£3,354	£1,200
2020	£5,724	£441	£1,562	£2,725	£996
2019	£5,750	£461	£1,486	£2,870	£932

The year to March saw continued strong performance in growth markets, as well as price falls for (fixed-interest) gilts and corporate bonds. In this environment, schemes that hold a high proportion of equities (such as most LGPS funds) will have fared best.

Liabilities

Discount rate

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 the increase in corporate bond yields from 31 March 2021 to 31 March 2022 – and beyond.



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 housing association board. We are seeing a growing trend towards receiving independent assumptions advice, rather than accepting the default assumptions provided by the scheme.

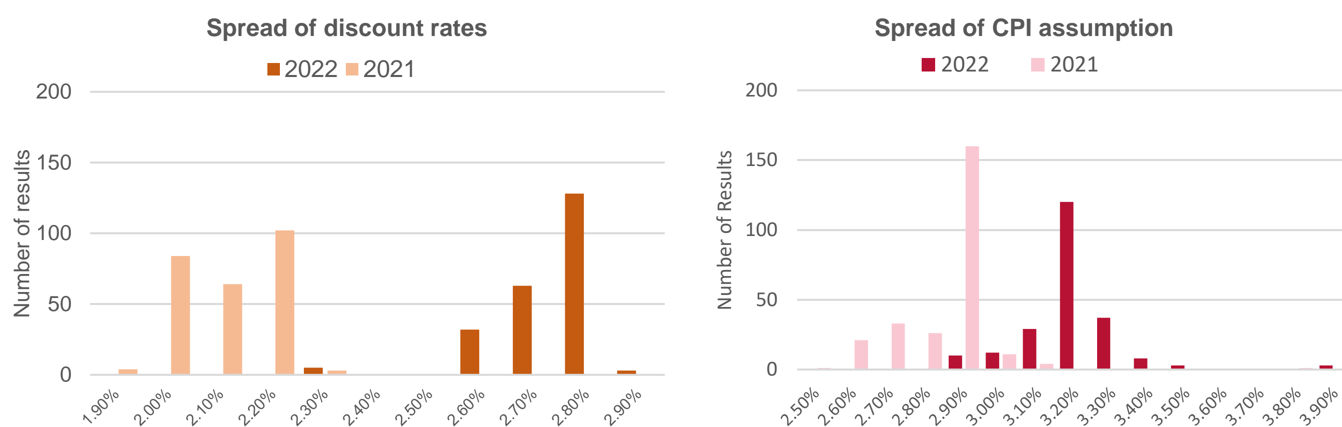
Even though different assumptions can sometimes be justified, the vast majority of results in our survey used a discount rate between 2.60% pa and 2.80% pa. This is in contrast to CPI inflation, where the assumptions are spread over a wider range.

Inflation

As there are no CPI market instruments, the CPI inflation assumption is derived firstly by setting an 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 gap between RPI and CPI (and CPIH).

CPI inflation assumptions in our survey typically ranged from 2.9% pa to 3.4% pa – a difference that could alter the value of liabilities by 10% to 15%. The most common assumption was 3.2% pa (far above the Bank of England's 2% pa target).



What does all this mean?

FRS 102 valuations provide interesting insights into scheme funding. However, they are not used to determine cash funding. For cash funding, 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. 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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