ACADEMIES – VALUATION APPROACH

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SUMMARY

During late 2010, schools gained the right to apply to the Secretary of State for Education to convert to Academy status. Over the period 1 November 2010 to 31 March 2013, 19 schools in London Borough of Hillingdon have converted to Academy Status. The initial decision by the Pension Fund was to treat all Academies as individual employers and to assess their employer contribution rates on an individual basis.

Recently, there has been increasing 'guidance' from Central Government on how local authorities should treat Academies for valuation purposes with the inference that treatment should be similar to local authority controlled schools.

This report is being brought to Pensions Committee to enable a review of the approach taken by London Borough of Hillingdon.

RECOMMENDATION

That Committee discuss the treatment of valuations and setting of employer contribution rates for Academies and agree an approach.

Background

Under the Academy Act 2010, when a school converts to an Academy they become a separate scheduled body within the LGPS. The Academy's employer contribution rate is calculated by the Fund actuary on an individual basis and the calculation method assesses a contribution rate based on the school's assets and liabilities and share of the fund's deficit at the date of transfer and includes liability for all future Deferred and Pension entitlements. Hillingdon retains liability for all benefits of employees who left employment of the school, before it became an Academy as there is no easy mechanism to calculate these liabilities.

Hillingdon currently has 28 Academies and their individual employer pension contribution rates have been assessed between 16.4% and 32.6%. Additionally each Academy has been informed of its notional value of assets within the fund, and their share of the pension fund deficit. Currently the deficit recovery period for Academies has been set at 20 years.

For comparison, for London Borough of Hillingdon the employer's contribution rate is 20.1% and the deficit recovery period is 25 years.

With the introduction of the Academies Act 2010, the Department for Communities and Local Government introduced a top slice mechanism of local authority funding to reflect the transfer of responsibilities away from the local authority onto the new Academy schools. Additionally local authorities Dedicated Schools Grant (DSG) funding was reduced based on the converting schools delegated budget share plus a top slice of the retained DSG (known as the Local Authority Central Spend Equivalent Grant (LACSEG) adjustment). This funding mechanism was replaced with the Education Services Grant, with effect from 1 April 2013, which effectively provides funding to the local authority and Academy schools based on a set rate per pupil (although the local authority base rate is £116 per pupil whereas the Academy school base rate is £150 per pupil). This funding is provided to cover the costs of delivering an Education service and in the case of Academy schools procuring a range of services that the local authority would have provided to schools. As more schools convert to Academy status, the less funding will be retained by a local authority to deliver an Education service. For Hillingdon this has resulted in a significant shrinkage in the size and shape of the Education service over the last few years to reflect the number of schools that have converted to Academy status.

In December 2011, the Secretaries of State for the Department of Education (DfE) and Communities and Local Government (CLG) issued a joint letter of understanding on the treatment of Academies in the LGPS. This set out a recommendation that Administering Authorities of the LGPS Pensions Funds should favourably consider "pooling arrangements" for Academies. A "pooling arrangement" is an arrangement which is generally set up for groups of employers which have similar characteristics and experiences, to protect employers in the pool from fluctuations in contribution rates between valuation periods.

One of the concerns raised by Administrating Authorities and actuaries was that the joint letter did not define what type of pooling arrangements should be applied to Academies, and who would take on the responsibility for deficits should, an Academy fail. If a failed Academy is unable to meet its pension liabilities then ultimately these liabilities would fall to the Fund and be spread across all employers within the Fund.

Then on 2 July 2013, the Secretary of State for Education confirmed in a statement to Parliament that the DfE would provide a guarantee to meet the outstanding pension liabilities, should an Academy close. However, the guarantee has a number of conditions applied. These include:

- An annual ceiling limit, which will mean no further payments would be made when the ceiling has been exceeded.
- HM Treasury reserve the right to withdraw the guarantee due to spending considerations or policy developments.

Additionally, projected costs of the guarantee are no longer affordable within the DfE's existing budget and projected costs are not approved by HM Treasury.

A key problem with this issue is that DfE are keen for Academies in the fund to be treated equitably with LEA schools, whereas the Fund needs to balance the interests of all employers in the fund, which would not necessarily result in similar contributions for two types of employer.

REVIEW OF VALUATION APPROACH

In light of the above communications and the change to funding Academies directly rather than through local authorities, it is timely for Pensions Committee to review their approach to Academy valuations. Also as the 2013 valuation is underway and change in approach needs to be incorporated into the revised Funding Strategy Statement. Further, two Academies have approached the Council to ask if it would be possible for Academies to be treated as part of the Council for valuation purposes, effectively 'pooled' with Hillingdon. (It should be noted that there have been no formal instructions received from CLG as to how Administering Authorities should move forward with Academies and the question of setting up pooling arrangements.)

The Pension Fund has three options in how Academies should be treated for valuation purposes:

1. To treat each as separate individual employers, fully responsible for their own liabilities, the current status quo;
2. To pool all Academies with London Borough of Hillingdon, effectively transferring part of the financial burden on to the Council; or
3. To create a separate pool for Academies.

If Committee agreed to one of the pooling options then all Academies would retain the right to remain wholly responsible for their own employer's contribution rate, rather than join any "pooling arrangement" agreed.

Option 1 - Retain current arrangements

When a school converts to an Academy the fund actuary calculates an employers' contribution rate for the school. The calculation method assesses a contribution rate based on the school's assets and liabilities and share of the fund's deficit at the date of transfer and includes liability for all future Deferred and Pension entitlements. Hillingdon retains liability for all benefits of employees who left employment of the school, before it became an Academy as there is no easy mechanism to calculate these liabilities.

Option 2 - Allow Academies to be "Pooled" with the London Borough of Hillingdon Pension Fund.

This option would allow Academies to elect to remain within the London Borough of Hillingdon Pension Fund, and continue to pay the same employers contribution rate as that of the Council. This option would provide the largest "pool" and therefore the most stable contribution rate for Academies. However, strict conditions would need to be placed on Academies that elected to join a pool, to ensure that the transfer of risk to the Council was managed as far as possible and that there was not an adverse impact on Hillingdon's Employer rate. These conditions are explained later in this report and, it should be noted, could cause Academies operational problems. In effect they would be giving up part of their financial autonomy as they would loose control over non-teaching staff wage policies. Regulations stipulate that Academies, as independent financial units, must have separate accounts and have their individual FRS17 liability calculated. As part of a Hillingdon pool this liability would effectively be a share of Hillingdon's liability and they would loose any right to control or manage any funding deficit. Contributions rates would be agreed by the Council and then applied to the Academy.

Option 3 - Set up a separate Academy "Pool" within the Pension Fund

Academies would be able to elect to participate in their own specific Academies Pool. This would require all Academies joining the pool to pay the same employers contribution rate, which would be would be based on the combined membership of all the Academies within the pool, as at the valuation date. The employer's contribution rate would be reassessed on the aggregate experience of the pool over the inter-valuation period, as is the case with the London Borough of Hillingdon Fund. We have received some "very approximate" employer's contribution rates from the Actuary, which produced an example "pooled rate" of 24.8%, based on Funding Assumptions as at 1 March 2012. Currently, there are 10 Academies with an employer's rate in excess of 24.8%.

While pooling can provide a less volatile employer contribution rate, which has benefits for the Academy when setting budgets, there is a risk that the Academy may pay a higher contribution as a result of subsidising other Academies in the pool, where their staff profile is younger than the rest of the pool, since funding rates are lower for younger scheme members. Membership of a pool would also result in loss of control for individual Academies; however, this may be considered an acceptable trade off in order to enjoy greater stabilisation of employer contributions.

Pooling Conditions

If any of the pooling options given above are agreed, all Academies, and any future converting schools, would have to sign a formal agreement, which would set out conditions for joining. These conditions would include but would not be restricted to: controls on the value of pay awards; controls on early retirement policies; and controls on any other discretion afforded to an employer which could affect the underlying employer contribution rate. Academies would also remain liable for early retirement costs.

In addition, a decision would also have to be made as to whether an Academy would have a "once only" option to join the pool, or retain the right to join at any time. The Council would have absolute discretion as to the conditions applying to membership of any pool.

FINANCIAL IMPLICATIONS

With employer contribution rates set at an individual Academy level, there is a broad range of rates currently in force. Two of the earliest Academies to convert enjoy a relatively low rate, but some of the more recent conversions are suffering considerably higher rates than Hillingdon's. Whilst the direct financial benefit from pooling with Hillingdon to the Academies could be significant, Hillingdon would need to put strong conditions in place to ensure that the Council did not effectively subsidies the Academies. From the Academies perspective, the loss of financial autonomy through pooling may be a price that is too high too pay.

LEGAL IMPLICATIONS

None at this stage.