2023 SHPS valuation: first reduction in deficit in a generation

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The preliminary results of the 2023 actuarial valuation of the Social Housing Pension Scheme (SHPS) have now been announced and, as expected, the deficit has more than halved. From April 2025, the majority of employers will see a reduction in the deficit contributions they pay, and for those employers with staff who are earning further defined benefits, the costs of new benefits will reduce significantly.

The headlines

- For the first time in a generation, the overall deficit has reduced - from over £1.5bn three years ago to less than £700 million today. Whilst still a huge sum, the deficit has not been this small since 2008.
- 94% of employers are expected to see a reduction in their deficit contributions over the period to 31 March 2028, with more than 70% of employers seeing a reduction of at least 10%.
- There has been a significant reduction in the cost of new benefits being earned in the SHPS defined benefit (DB) sections, with total costs reducing in some cases by as much as 60%.
- The aggregate cost of exiting SHPS has reduced from almost £5bn three years ago to less than £1.5bn in September 2023, and we estimate it has continued to reduce since. **This reduction in exit costs is a key change that presents opportunities for employers in SHPS.**

Actions

ANY EMPLOYERS WITH EMPLOYEES EARNING DB PENSIONS IN SHPS MUST:

- Decide what benefits to offer in the future, and how the reduction in cost will be split between the employer and the individual. There is no 'default', so employers must make an active decision.
- Inform / consult with members as appropriate and inform TPT **by 31 January 2025**. In some cases, this may mean a decision is required by mid-October.
- Given the scale of the change in cost, it may not simply be a case of maintaining past practice.
- This is particularly true for any employer offering membership of the CARE 120ths section – SHPS has confirmed that it will be suspending that section for at least the next three years.

ALL EMPLOYERS SHOULD:

- Understand the impact of these results on cash contributions and incorporate changes into business plans.
- Understand the risks that SHPS poses to your organisation.
- Review your options to manage risks and liabilities in relation to SHPS (and any other DB schemes where you are an employer).

LCP comment: Even if pensions were reviewed recently, the position today could be vastly improved, and options which were discounted as being unaffordable may be back on the table.

There is a real opportunity for associations to significantly improve their financial strength and resilience, which some associations have already captured.

The valuation in numbers, since 2020:

55% reduction in ongoing deficit

2% improvement in funding level

94% of employers will see a reduction in deficit contributions over the period to 2028

60% reduction in total cost of providing future service benefits

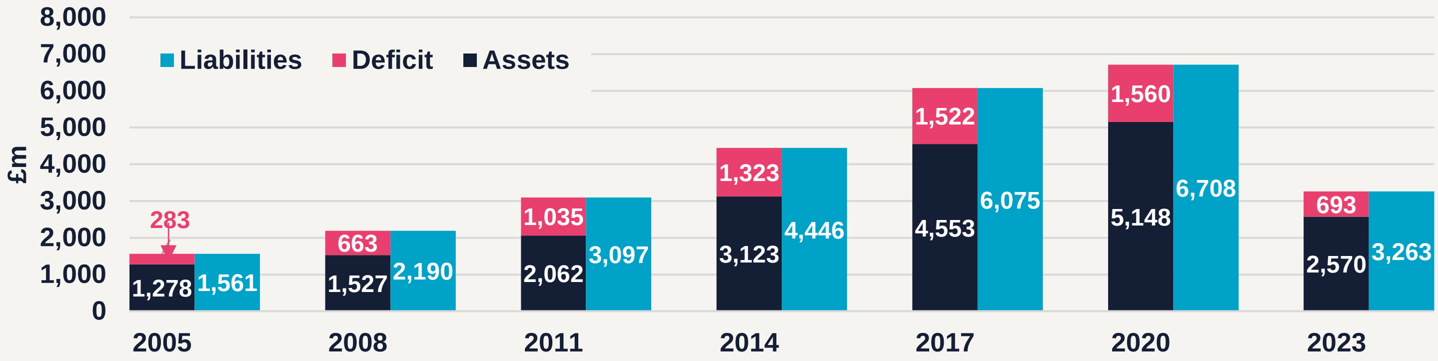
60%+ average reduction in exit cost for an employer

20% share of SHPS that employers have transferred out since 2020

The detail – what are the results?

How has the funding position changed? And why has it moved so much?

The results of the valuation showed a significant drop in the deficit, from £1.56bn in 2020, down to £697m in 2023. The chart below puts that into context of the last seven valuations – it is the first time we have seen the deficit reduce. In fact, the position is back now to a deficit of a size not seen since 2008. But even more stark is the sheer scale of the reduction in the quantum of the liabilities and assets in SHPS – it is roughly half the size it was three years ago.



But why has the position changed over the three years? And should the deficit have actually reduced by even more? In fact, if you dig down into the numbers, there are two separate issues at play here:

1. Why has the deficit reduced?

There are two key reasons why the deficit has reduced – firstly, **employers have paid a significant amount in contributions** over the last three years to reduce the deficit – in total around £0.4bn.

In addition, there have been some significant transfers out of SHPS and exits over the last three years – with perhaps 20% of the liability in the scheme exiting or transferring elsewhere. The **employers who have transferred liabilities out of SHPS will have taken their share of the deficit with them**, meaning the deficit has reduced as a result. In fact, these transfers explain around another £0.4bn of the reduction in deficit.

TPT Benefit Review

The 2023 valuation results make no allowance for any potential additional liabilities from the TPT benefit review.

The associated legal case is scheduled to be heard by the court in February 2025, with a ruling expected in the summer of 2025.

Any additional liability is likely to be picked up in the 2026 valuation. SHPS have previously calculated a figure of 4% of liabilities – which could translate into an extra £130m if the case goes against TPT.

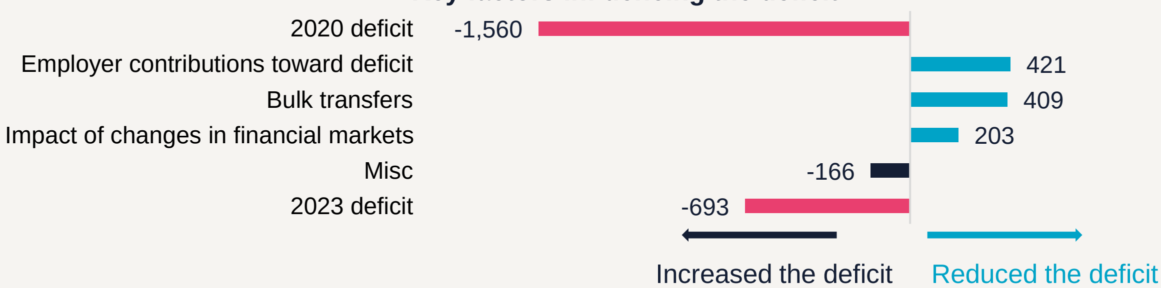
2. Why are the SHPS liabilities half the size they were three years ago?

Here the main cause is the **increase in long term interest rates**, which has increased expected future investment returns, and hence reduced the value placed on the liabilities. In all, the yield on long term gilts rose from 0.6% pa as at 30 September 2020, to 4.8% pa as at 30 September 2023.

Each 1% pa change equates to a reduction of c.15% on the value placed on the liabilities, which means this change explains the bulk of the reduction in the size of SHPS, particularly when combined with the transfers mentioned above.

On the asset side – a significant proportion of the assets are invested to move in the same way as liabilities.

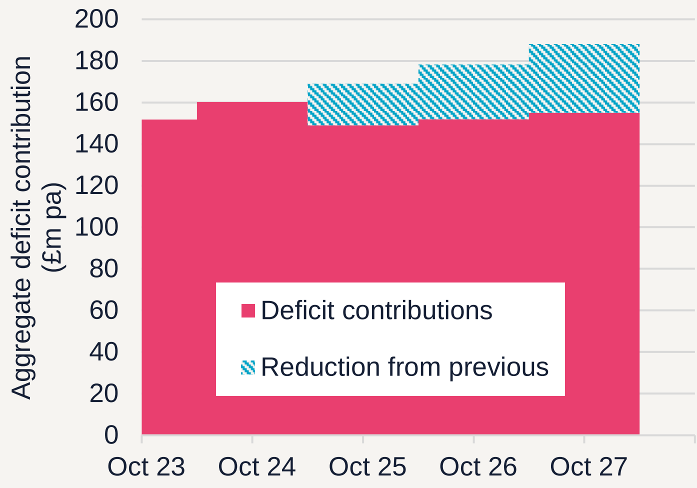
Key factors influencing the deficit



The assets have broadly achieved that, meaning that both the assets and liabilities have broadly halved. All else equal, the assets and the liabilities both halving could mean the deficit i.e. the gap between the two also halving. However, the assets have dropped by a larger proportion than the liabilities, meaning the deficit has not fallen in the same way.

LCP comment: Whilst the reduction in deficit and deficit reduction contributions is welcome, the above analysis, and our experience of other schemes, suggests that if anything we might have expected a bigger reduction in the deficit.

The detail –how are contributions changing?



Deficit contributions:

The current recovery plan is aiming to repay the deficit by 31 March 2028. Allowing for transfers out of SHPS, the Recovery Plan included aggregate contributions of £169m in the year starting 1 April 2025, with this amount increasing by 5.5% each year.

In fact, the improvement in funding position means that those contributions can reduce to an aggregate of £149m, with future increases being restricted to 2% pa. Whilst the contributions will be rebalanced amongst employers depending on their share of the total liability, SHPS have stated that 94% of employers should see a reduction in aggregate contributions over the next three years.

Expenses:

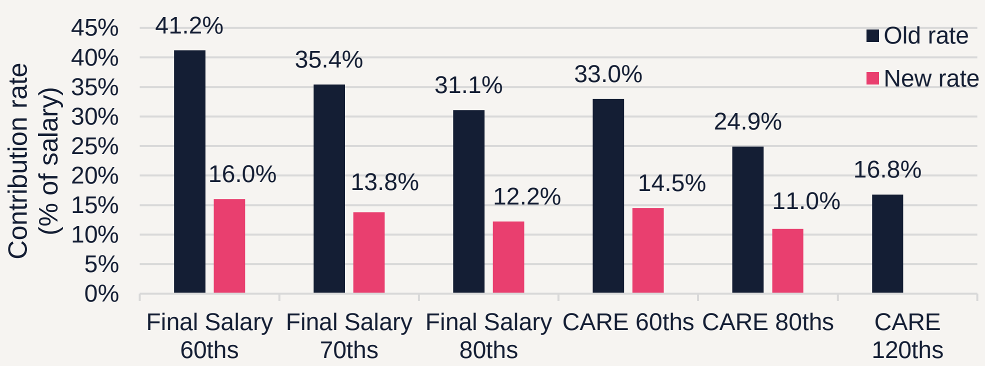
As well as deficit contributions, employers need to pay for the expenses of running SHPS. These expenses are increasing significantly, with an employer with 1,000 current and former staff seeing their annual expenses increase from £80,900 to £110,900 in 2025, and £127,900 by 2027, an increase of almost 60%.

	Employer (£ pa)	Per member (£pa)
Current	£1,900	£79
From April '25	£1,900	£109
From April '26	£1,900	£120
From April '27	£1,900	£126

Cost of new benefits accruing:

Perhaps the most pressing issue emerging from the 2023 valuation, and the one that will need urgent action from relevant employers, is the material reduction in the contribution rates payable for employees who continue to earn defined benefit pensions in SHPS. For example, the cost of Final Salary 60ths has dropped from 41.2% of pensionable salary to 16% of pensionable salary – a mammoth reduction of 25% of salary.

Details of any changes will need to be notified to SHPS by 31 January 2025. Importantly, **there will be no default option**, meaning **all employers with current employees earning DB pensions in SHPS will need to actively decide how to proceed**.



The cost of the CARE 120ths section has reduced so significantly it no longer satisfies auto-enrolment requirements. As a result, the section will be suspended.

Any employers who are using the CARE 120ths section will need to decide on an alternative benefit.

LCP comment: These are significant changes to the contributions rates, and in many cases simply applying past practice to changes may not be the appropriate response. Housing associations need to decide their approach promptly in order to be able to notify TPT by 31 January 2025, especially if a consultation with staff is required.

Closed scheme surcharge:

Employers who have closed their DB sections to new entrants are charged an additional 'surcharge', reflecting the fact that their section is expected to age quicker than an open section. For this valuation, the closed scheme surcharge has been increased from 0.3% to 0.6% of pensionable salary. Frankly, given the huge reductions we have seen to the ongoing contribution rates, it would be a surprise if many employers even noticed the change – in essence it means contribution rates for these employers will reduce by 0.3% of salary less than for employers who offer SHPS DB to new joiners.

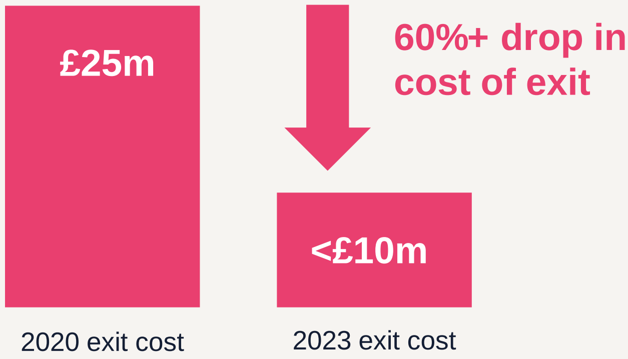
The detail – what about the cost of exit?

The cost of exiting SHPS **has reduced significantly**, largely driven by the same reasons as the improvement in the ongoing funding position.

Employers were notified of their estimated exit debt at 30 September 2023 in May 2024. The graphic to the right shows how the cost of exit has changed between 2020 and 2023 for a typical employer, who might have seen a reduction of 60% or more. If your cost of exiting had been £25m three years ago, that could have now dropped to less than £10m.

Many organisations that rejected that £25m as unaffordable could be much more interested in the idea of paying £10m or less to extinguish their SHPS exposure. This highlights the importance of associations ensuring they are working from the most up-to-date information when making decisions.

Reduction in exit cost for a typical housing association



In all, since 2020 the aggregate debt across all employers has dropped from £4.9bn to £1.4bn at 30 September 2023.

In fact, we estimate the position has continued to improve since the valuation date and so, if anything, the cost today may be even less.

Options for employers to manage risks in SHPS

There are three key options for employers in relation to existing liabilities:

1. **Maintain status quo**
2. **Transfer out of SHPS to an alternative arrangement**.
3. **Exit SHPS and pay exit debt.**

The right answer in your situation will depend on factors such as your particular circumstances, size and nature of participation in SHPS, strategic priorities and attitude to risk. We expect the valuation to be a prompt for many organisations to review their options – please contact our experts below.

We are proud to be the National Housing Federation's preferred supplier for pensions advice. We have put together a cost-effective package of advice on the SHPS valuation, with exclusive discounts for NHF members. Please visit https://go.lcp.com/3YMgCjM to find out more.

Our specialist team have advised associations representing around 25% of the English social housing market, with organisations ranging in size from under 5,000 units to over 200,000 units. If you would like to find out more, please visit https://www.lcp.com/en/pensions-benefits/services/not-for-profit/housing-associations or contact one of the experts below.

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