

LINCOLNSHIRE COUNTY COUNCIL
LOCAL GOVERNMENT PENSION SCHEME
ANNUAL REPORT FOR THE YEAR ENDED 31 MARCH 2003

CONTENTS	Page
Management arrangements	1
Report of the Pensions Committee	2
Management Report of the Administering Authority	4
Fund Account	8
Audit Opinion	9
Actuarial Statement	10
Investment Background	11
Summary of benefits	16
Participating Employers	17

MANAGEMENT ARRANGEMENTS

Administering Authority Lincolnshire County Council

Pensions Committee Members at 31 March 2003

County Councillors

M J Hill (Chairman)

N T Carter OBE

R A Coupland

A Davidson

R A Day DFC

D R Dickinson

J D Hough

M D Kennedy

J Libell (Vice Chairman)

R B Parker

Mrs S E Roy

B G Singleton

T C Taylor

A H Turner MBE JP

Mrs P F Watson

C B Wood

Lincolnshire Local Government Association

G W Chambers

K Whaley

Representatives of Other Employers

A Battle

Trade Union representative

J Sharman

Professional Advisers

County Council Officers

County Treasurer

Assistant County Treasurer

P Moore BA CPFA

D C Forbes BSc CPFA

Independent Adviser

Neil Dunford

Consulting Actuary

Hymans Robertson, Glasgow

Voting Adviser

Manifest Voting Agency

Investment Managers of segregated portfolios

Deutsche Asset Management Ltd
INVESCO Asset Management Ltd

Bank of Ireland Asset Management (UK) Ltd
Morley Investment Management Ltd

Auditors

KPMG, Birmingham

Investment Custodian

HSBC Bank plc

REPORT OF THE PENSIONS COMMITTEE

Introduction

The Lincolnshire County Council Pensions Committee approves the investment policy of the Fund and monitors its implementation during the year. The Committee meets, as a minimum, on a quarterly basis and special meetings are convened if considered necessary. No special meetings were held in the twelve months ended 31 March 2003.

Members of the Committee at 31 March 2003 are listed on page 1.

Revised strategic asset allocation

Hymans Robertson, the Fund's actuary, produces a triennial report on the Fund's assets and liabilities and recommends an appropriate strategic asset allocation. A considerable proportion of the Committee's time during the year has been devoted to the evaluation and implementation of Hyman's recommendations that were produced in March 2002.

In response to reduced expectations of future returns from equities and the increasing proportion of pensioners in the scheme, Hymans Robertson advised the Committee to reduce the allocation of investments to equities and increase the amount of Fixed Interest securities held within the Fund. Hymans Robertson also recommended that it would be beneficial to increase the share of overseas equities in the Fund relative to UK equities.

Revised investment management arrangements

To implement the revised strategic asset allocation recommended by Hyman's, the Committee decided that the investment management arrangements for the Fund should be revised. The reduction in the

allocation to UK equities was achieved, in part, by the termination of a mandate held by Friends Ivory and Sime to manage a small portfolio of UK shares. In respect of the management of overseas equities, the Committee terminated the existing regional mandates for the Bank of Ireland Asset Management and Schroders Investment Management. A new mandate to manage a global portfolio of equities was awarded to Bank of Ireland Asset Management and the County Treasurer's office was instructed to establish an index-tracking portfolio of European equities.

In light of the significant increase in Fixed Interest investments the Committee resolved to test the market for appropriate managers, with the incumbent manager Morley Fund Managers pre-selected for a shortlist of candidates to be interviewed by the Committee in the summer of 2003.

Private Equity

To diversify the Fund's investments and to seek to enhance investment returns, the Committee had previously instructed the County Treasurer's office to arrange investments in appropriate pooled vehicles providing investment exposure to unquoted companies. During the year, the Fund committed to invest in three Private Equity Fund's managed by Pantheon Private Equity.

Independent Adviser

Mr. Peter Moon, the Chief Investment Officer of the Universities Superannuation Scheme, had provided valuable independent advice to the Committee since 1996. Following Peter's appointment as an independent adviser to the London Pension Fund Authority, he resigned from his role with Lincolnshire. The Committee has been fortunate in obtaining the services of Mr. Neil Dunford as independent

adviser. Neil recently retired from his position as Executive Chairman of Deutsche Asset Management's UK institutional business.

Pension Scheme Governance

At the start of the year, the ten best practice recommendations for Pension Fund management, as identified in the review of Institutional Investment in the UK carried out by Sir Paul Myners, were incorporated into the regulations governing the Local Government Pension Scheme. The Committee approved a revised Statement of Investment Principles that comments on the Fund's compliance with the principles of best practice. The management of the Lincolnshire Fund largely complies with the best practice proposals, but the review identified the need to improve both training for the Committee members and investment manager monitoring. The Committee agreed action by the County Treasurer to develop training for Committee members and to make enhancements to the monitoring of Fund's investment management activity.

The Fund's investments are managed in accordance with the Statement of Investment Principles (SIP). Copies of the SIP may be obtained from David C Forbes, Assistant County Treasurer – Lincolnshire County Council, County Offices, Newland, Lincoln, LN1 1YL. (Tel: 01522 553642) (email : dcf@lincolnshire.gov.uk)

Pension Scheme Reform

The year has seen a considerable amount of consultation from the government in respect of both proposed changes to the national arrangements for pension provision and issues specific to the Local Government Scheme. The Committee has responded to all the relevant consultations and expects that the impetus to revise pension arrangements is unlikely to abate in the near future.

Investment Performance

For the third year in succession the Fund has declined in value as world equity markets have continued to fall. The twelve months to 31 March 2003 were one of the worst years for stock markets in living memory, as faltering economic activity worldwide, large scale corporate scandal in the US and the invasion of Iraq, all served to undermine investor confidence. The Fund's decline of 19.3% is very disappointing but, as a long-term investor, the Committee takes some comfort from the fact that more signs of economic recovery are becoming apparent and world equity markets at current levels appear to offer fair value to investors.

The Fund's managers generally performed well in these difficult markets and, in spite of the inevitable costs associated with changes to manager arrangements during the year, the Fund outperformed the benchmark target by a significant margin of 3.7%.

M J HILL
CHAIRMAN
PENSIONS COMMITTEE

The Local Government Pension Scheme (LGPS) is a national scheme administered on a local basis by Lincolnshire County Council. During the year active membership decreased by 270 (1.6%) to 16,547, membership details over the five years to 31 March 2003 are shown in the table below.

Local Government Pension Scheme membership

Year ended 31 March	1999	2000	2001	2002	2003
Contributors	15,653	16,391	16,213	16,817	16,547
Pensioners	8,554	8,820	9,065	9,266	9,486
Deferred Beneficiaries	4,601	5,149	7,298	8,079	8,789
Total	28,808	30,360	32,576	34,162	34,822

(Note: The numbers disclosed in the table above reflect individual pension records within the County Council's database. Current and past members of the LGPS may have more than one pension record as a result, for example, of having more than one part time contract of employment with a Scheme employer.)

Investment policy

The Fund is managed with regard to a strategic asset allocation benchmark that, following advice from the actuary, was revised during the year.

Strategic Asset Allocation Benchmark

Asset class	Strategic Benchmark 1 April 2002 to 30 September 2002 %	Strategic Benchmark 1 October 2002 to 31 March 2003 %
UK Equities	56.00	40.0
North American equities	7.00	8.9
European Equities (ex UK)	7.00	8.9
Japanese equities	5.10	3.8
Pacific equities (ex Japan)	5.10	3.8
Emerging markets	1.30	1.6
Private Equity	-	3.0
Total Equities	81.50	70.0
Index Linked Gilts	6.20	5.0
Overseas Fixed Interest	1.15	1.5
UK Conventional Gilts	1.15	2.0
UK Corporate Bonds	1.00	10.0
Total Fixed Interest	9.50	18.5
Property	7.50	10.0
Cash	1.50	1.5
Total	100	100

Investment performance

The twelve months period ended 31 March 2003 saw the value of the Fund fall by £139 million to £620m. The negative investment return of 19.3% was ahead of the fall in the Fund's specific benchmark that declined by 22.2%. Over the last ten years, the annualised investment performance of the Fund has exceeded the benchmark with a return of 6.7% compared to 6.2%.

Annual investment performance over the previous ten years is set out in the table below. The Fund's annual return of 6.7% has exceeded increases in both consumer prices (2.6% p.a.) and average earnings (4.4%).

Investment performance of the Fund 1 April 1993 to 31 March 2003

	Lincolnshire Fund Return	Comparative Benchmark Return	Retail Price Inflation	Annual Wage Increases
	%	%	%	%
1993/94	18.1	16.9	2.3	3.9
1994/95	0.7	2.4	3.5	3.9
1995/96	23.9	23.1	2.7	3.6
1996/97	10.4	12.6	2.6	4.4
1997/98	27.5	25.7	3.5	5.5
1998/99	7.8	9.2	2.1	4.8
1999/00	16.1	15.2	2.6	5.4
2000/01	-8.0	-9.2	2.8	4.4
2001/02	-0.9	-1.2	1.3	3.5
2002/03	-19.3	-22.2	3.1	4.7
10 years annualised	6.7	6.2	2.6	4.4

Investment Management Arrangements

The arrangements for segregated management of the Fund's assets, in place at 31 March 2003, are set out below.

Segregated Investment Management Mandates

Asset Class	Manager	Portfolio Market value £m's	Portfolio as a % of the Fund %
Fixed Interest	Morley Asset Management	82.1	13.2
UK Equities	Lincolnshire County Council	148.7	24.0
UK Equities	Deutsche Asset Management	92.3	14.9
Global Equities	Bank of Ireland Asset Management	90.7	14.6
US Equities	INVESCO Asset Management	33.1	5.3
Pan European Equities	Lincolnshire County Council	38.0	6.1
Total Equities		402.8	64.9

The Fund invests in emerging markets equities, UK commercial property and Private Equity by holding units in a range of collective investment funds.

Property, Private Equity and Emerging Markets collective investment vehicles

Asset Class	Manager	Market value of holding £m's	Holding as a % of the Fund %
Property	Standard Life Corporate Property Fund	30.4	4.9
	Standard Life European Property Fund	3.3	0.5
	Deutsche UK Property Funds	18.0	2.9
	Royal London Property Unit Trust	8.5	1.4
	Morley Property Fund	14.4	2.3
Total UK Property		74.7	12.0
Emerging Markets	SSGA Emerging Markets Funds	3.7	0.6
	Pictet Targeted Fund	2.6	0.4
	Foreign and Colonial Emerging Market Fund	2.3	0.4
Total Emerging Markets		8.6	1.4
Private Equity	Standard Life	2.4	0.4
	Westport Private Equity	8.3	1.3
	Pantheon Private Equity	0.8	0.2
Total Private Equity		11.5	1.9

Actuarial position

The employers' contribution rates applying in the year ended 31 March 2003, for employers with more than 100 employees participating in the LGPS, are set out below.

Employers' contribution rates 2002/2003

Employer	Contribution rate %
Lincolnshire County Council	260
Boston Borough Council	290
East Lindsey District Council	285
Lincoln City Council	325
North Kesteven District Council	260
South Holland District Council	230
South Kesteven District Council	270
West Lindsey District Council	340
Lincolnshire Police Authority	250
Lincolnshire Probation and After Care Committee	290
Boston College	225
Lincoln College	225
Stamford College	225
Linx Homes	250

(Employers' contribution rates are expressed as a percentage of employees' contributions)

Administration of benefits

Lincolnshire County Council has contracted with HBS to administer LGPS benefits and other services. Former LGPS members who now work for HBS have the right to transfer their accrued pensions to their new employer's scheme. The value of assets to be transferred to the HBS pension scheme to reflect the value of the transfer elections has been agreed. The transfer of assets from the Fund is expected to take place during the financial year 2003/04.

The principal points of contact in respect of questions about the LGPS are:

Investments David C Forbes, Assistant County Treasurer – Lincolnshire County Council, County Offices, Newland, Lincoln, LN1 1YL. (Tel: 01522 553642)
(email : dcf@lincolnshire.gov.uk)

Pensions David Vickers, Pensions Manager – HBS, Mill House, Brayford Wharf North, Lincoln, LN1 1YT (Tel: 01522 836453) (email: dave.vickers@hbs.uk.com)

P Moore BA CPFA
County Treasurer

**LINCOLNSHIRE COUNTY COUNCIL PENSION FUND ACCOUNT & NET ASSETS
STATEMENT FOR THE YEAR ENDED 31 MARCH 2003**

	2002/2003 £000	2001/2002 £000
<i>FUND ACCOUNT</i>		
CONTRIBUTIONS & BENEFITS		
Contributions receivable	40,732	36,415
Transfers in	8,110	7,727
	<u>48,842</u>	<u>44,142</u>
Benefits payable	34,788	33,956
Leavers	5,843	4,852
Administrative expenses	642	587
	<u>41,273</u>	<u>39,395</u>
NET ADDITIONS (WITHDRAWALS) FROM DEALINGS WITH MEMBERS	7,569	4,747
RETURNS ON INVESTMENTS		
Investment management expenses	(1,875)	(1,961)
Investment income	16,497	17,134
Change in market value of investments	(161,889)	(26,603)
NET RETURNS ON INVESTMENTS	<u>(146,267)</u>	<u>(11,430)</u>
NET DECREASE IN THE FUND	(138,698)	(6,683)
<i>NET ASSETS OF THE SCHEME</i>		
OPENING NET ASSETS AS AT 1st APRIL	759,019	765,702
CLOSING NET ASSETS AS AT 31st MARCH	620,321	759,019
<i>NET ASSET STATEMENT</i>		
INVESTMENTS		
FIXED INTEREST SECURITIES	25,848	27,410
EQUITIES	388,189	534,586
INDEX LINKED SECURITIES	55,794	44,931
MANAGED FUNDS AND UNITISED TRUSTS	105,220	112,242
CASH DEPOSITS	4,651	2,728
TOTAL INVESTMENTS	<u>579,702</u>	<u>721,897</u>
CURRENT ASSETS & LIABILITIES	40,619	37,122
CLOSING NET ASSETS AS AT 31st MARCH	<u><u>620,321</u></u>	<u><u>759,019</u></u>

AUDIT OPINION

ACTUARIAL STATEMENT

INVESTMENT BACKGROUND

Returns for major markets

Worldwide equity market returns over the twelve months ended March 2003 were very poor with sterling investors losing approximately 25% to 35% of their investments, irrespective of the region they chose to invest in.

Fixed Interest markets benefited in an environment where central banks were continuing to reduce interest rates, investors were seeking safe assets and inflation remained subdued. Overseas Bonds, UK Corporate Bonds, UK Conventional and Index Linked Gilts all produced returns in the range 10% to 13%.

Commercial Property in the UK produced an overall return of almost 11%, supported by rental yields in excess of 7% that were comfortably above the return on cash of 3.7%.

Investment Returns to sterling based investors 1 April 2002 to 31 March 2003

Asset Class	Index	Index return to sterling investors %
Equities		
United Kingdom	FTSE All Share	(29.8)
United States	S&P 500	(32.2)
Europe	FTSE Europe (ex UK)	(34.2)
Japan	TOPIX	(24.1)
Far East	FTSE Pacific (ex Japan)	(26.4)
Emerging Markets	IFCI Composite	(28.3)
Fixed Interest		
UK Index Linked Gilts	Barclays Over 5 Years Index Linked	10.6
UK Gilts over 15 years	Barclays Over 15 years UK Gilts	13.0
Overseas Bonds	JP Morgan Non – UK Governments	12.1
UK Corporate Bonds	Barclays over 15 years UK Corporates	11.1
Property	IPD All Properties	10.6
Cash	Local Authority Seven Day Rate	3.7

MARKETS OVER THE REPORTING PERIOD

World Equity Markets

- The first half of the year saw equity markets decline in response to a slowdown in worldwide economic growth and falls in consumer confidence and company earnings.
- Investor confidence was further undermined by a series of scandals at a number of large US companies, with accountancy related frauds leading to, in the case of WorldCom, one of the largest bankruptcies in history and, in the case of Tyco, the Chief Executive being charged with corruption.
- In the second half of the year markets weakened further as geopolitical tensions escalated in the run up to the invasion of Iraq, the oil price exceeded \$30 a barrel and investors rushed to buy 'safe haven assets' at the expense of most equities.
- The initial phase of the invasion of Iraq saw equity markets in early March 2003 reaching levels last seen in the middle of the 1990s, although as the war progressed markets began to recover strongly.
- The UK equity market in particular suffered as a result of insurance companies selling significant proportions of their equity holdings.
- To support economic activity the Bank of England reduced the base rate from 4.0% to 3.75% in February 2003, representing the lowest rates in the UK for almost fifty years.
- To reduce the threat of deflation in the US economy, the Federal Reserve reduced the central bank rate in November 2002 from 1.75% to 1.25%. Concerned about slow growth in Europe, the European Central Bank reduced its central rate from 2.75% to 2.5%.
- Despite strong returns over the year, Fixed Interest markets remain vulnerable to stronger than expected increases in economic growth and inflation. The supply of Fixed Interest securities increased significantly, as companies took advantage of low interest rates to issue new debt and governments sought to fund escalating deficits.

Commercial Property

- Overall, Commercial Property in the UK returned 10.6% with retail property, after several relatively poor years compared to offices and industrial property, benefiting most from high investor demand.
- After several years as the worst performing sector of the property market, the retail sector returned some 15%, ahead of offices and industrial properties providing 4% and 10% respectively.
- Investor demand for high yielding property remained strong over the year.

Fixed Interest Markets

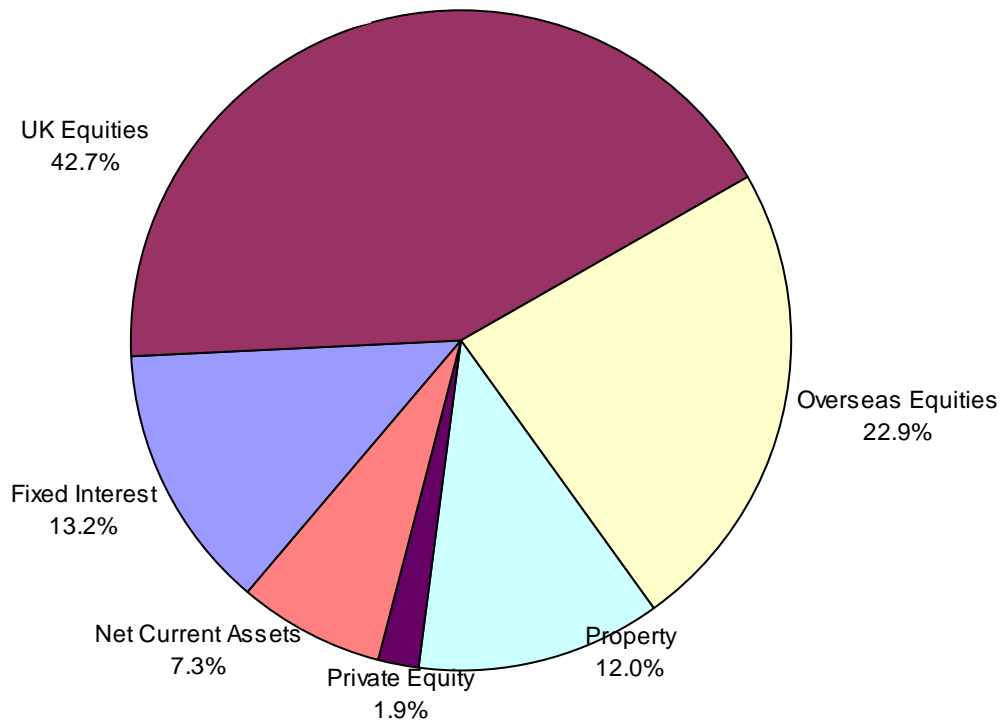
- Fixed Interest markets benefited in an environment where central banks were continuing to reduce interest rates, investors were seeking safe assets and inflation remained subdued.

ASSET DISTRIBUTION AT 31 MARCH 2003

Asset class	Market Value £000	31/3/03 %	31/3/02 %
Fixed Interest	81,642	13.2	9.6
UK Equities	265,091	42.7	51.0
Overseas Equities	142,074	22.9	24.1
UK Property	74,706	12.0	9.6
Private Equity	11,538	1.9	0.9
Cash & Other Net Current assets	45,270	7.3	4.9
Total	620,321	100.0	100.0

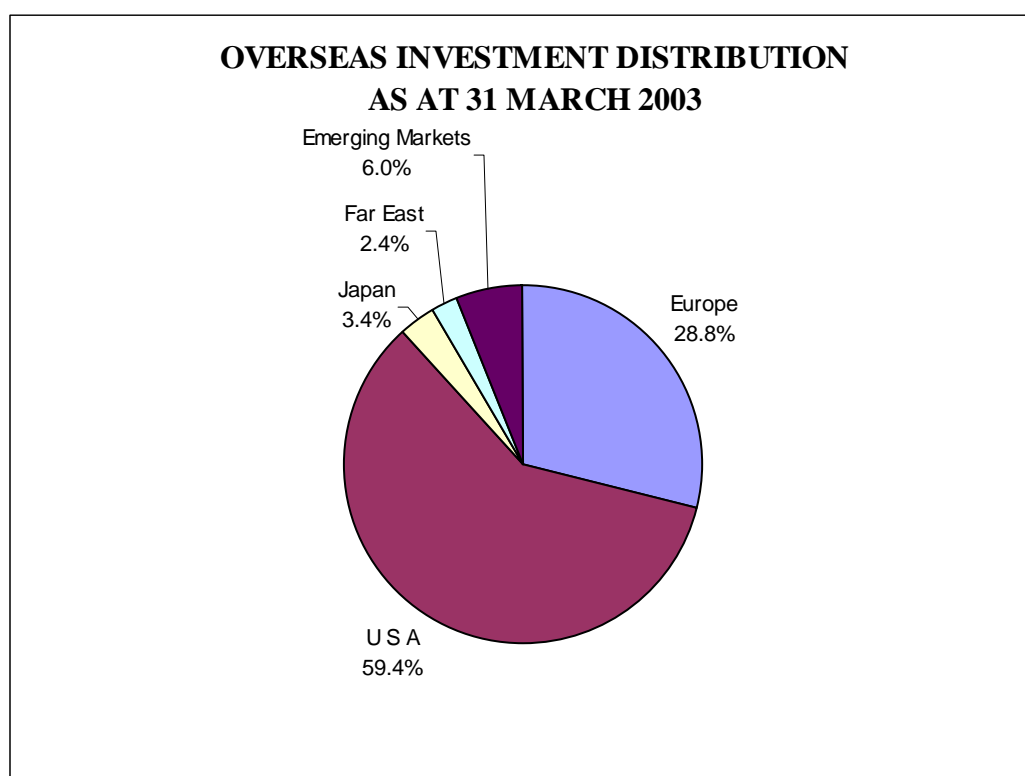
GLOBAL INVESTMENT DISTRIBUTION

ASSET ALLOCATION AS AT 31 MARCH 2003



OVERSEAS EQUITIES ASSET DISTRIBUTION AS AT 31 MARCH 2003

Asset class	Market Value £000	31/3/03 %	31/3/02 %
Europe (Excluding United Kingdom)	40,879	28.8	31.1
United States	84,431	59.4	25.1
Japan	4,803	3.4	16.4
Far East (Excluding Japan)	3,380	2.4	21.3
Emerging Markets	8,581	6.0	6.1
Total	142,074	100.0	100.0



TWENTY LARGEST HOLDINGS IN THE FUND AS AT 31 MARCH 2003

	Market Value £000	Proportion of Fund %
Standard Life Corporate Property Fund	30,443	4.9
BP	23,183	3.7
Vodafone	19,888	3.2
Glaxo Smithkline	18,592	3.0
Deutsche UK Managed Property Fund	17,995	2.9
HSBC Holdings	17,311	2.8
Treasury 2.5% Index Linked 2020	15,639	2.5
Morley Property Fund	14,369	2.3
Morley Corporate Long Dated Bond Fund	12,325	2.0
Treasury 2.5% Index Linked 2016	11,007	1.8
Shell Transport & Trading	10,886	1.8
Astrazeneca	10,678	1.7
Royal Bank of Scotland	10,604	1.7
Treasury 2.5% Index Linked 2024	8,076	1.3
Royal London Exempt Property Unit Trust	7,736	1.2
Treasury 2.5% Index Linked 2013	6,210	1.0
Barclays	6,185	1.0
Treasury 2.5% Index Linked 2011	6,061	1.0
Diageo	5,978	1.0
Unilever	5,868	0.9
Total	259,034	41.8

SUMMARY OF LGPS CONTRIBUTIONS AND BENEFITS

Membership of the LGPS is available to all contracted employees of participating employers whether whole time, part time or casual. While membership of the Scheme is not compulsory for employees, new employees are deemed to have joined the Scheme unless they specifically opt out.

National legislation and regulation cover the LGPS including the benefit entitlements of Scheme participants and their families. Such benefits are not linked to the investment performance of the Fund. Key features of the contributions payable and the benefits available are outlined below:

Contributions

Employees contribute 6% of their pensionable pay towards their pension, the exception being manual workers who were Fund members before 1 April 1998 who pay 5%.

Benefits

The normal retirement age for Scheme members is 65 but employees in the Scheme prior to 1 April 1998 can retire at 60 provided they have 25 years service. Retirement before these ages, other than on ill-health grounds, is not possible without the permission of the employer.

Annual Pensions

Pensions are calculated at a rate of $\frac{1}{80}$ th of the employee's pensionable pay in their last twelve months of employment for each year of service up to a maximum of 40 years. Pensions for persons aged 55 and over are linked to the movement in the Retail Price Index.

Lump Sum Payments

A retiree receives a lump sum payment upon ceasing work equating in general, to three times the annual pension.

Benefits are as for normal retirement but with additional years added dependent on the length of service.

Death-benefits

Death in service attracts a lump sum grant equivalent to up to twice final pensionable pay. An annual pension is payable to the surviving spouse and any eligible children. For death after retirement a single payment is made of five times the member's annual pension (less any pension paid since retirement.) The surviving spouse is entitled to an annual pension of up to 50% of the member's pension for the rest of their life.

Supplementary Pensions

Scheme members may purchase additional service within the Scheme provided that they would not normally be able to achieve 40 years service by their normal retirement age. As an alternative, Scheme members may increase their benefits by paying Additional Voluntary Contributions, up to limits imposed by the Inland Revenue, to a private pension provider under an arrangement sanctioned by the County Council.

Ill Health Retirement

LIST OF PARTICIPATING EMPLOYERS

Employing authorities who are participating members of the Fund at 31 March 2003

Scheduled Authorities

Black Sluice Internal Drainage Board
Boston Borough Council
Boston College
Bourne Town Council
Branston & Mere Parish Council
Cherry Willingham Parish Council
City of Lincoln Council
Crowland Parish Council
Deeping St James Parish Council
East Lindsey District Council
Grantham College
Heighington Parish Council
Horncastle Town Council
Ingoldmells Parish Council
Langworth Parish Council
Lincoln College
Lincolnshire County Council
Lincolnshire Magistrates Courts Committee
Lincolnshire Police Authority
Lincolnshire Valuation Tribunal
Lindsey Marsh Drainage Board
Louth Town Council
Mablethorpe and Sutton Town Council
Nettleham Parish Council
North East Lindsey Internal Drainage Board
North Hykeham Town Council
North Kesteven District Council
Skegness Town Council
South Holland District Council
South Holland Internal Drainage Board
South Kesteven District Council
Stamford College
Stamford Town Council
Sudbrook Parish Council
Upper Witham Internal Drainage Board
Washingborough Parish Council
Welland and Deeping Internal Drainage Board
West Lindsey District Council
Witham First Internal Drainage Board
Witham Fourth Internal Drainage Board
Witham Third Internal Drainage Board

Admitted Authorities

ACIS Group
Bishop Grosseteste College
Boston Mayflower
Centre for British Teachers
City of Lincoln Archaeological Unit
East Lindsey Housing Partnership
Heritage Trust for Lincolnshire
Lincolnshire Tourism
Lincolnshire Trust for Nature
Linx Homes
Sleaford Development Group