

APPENDIX A DRAFT ANNUAL REPORT FOR 2003/04

LINCOLNSHIRE COUNTY COUNCIL

LOCAL GOVERNMENT PENSION SCHEME

ANNUAL REPORT FOR THE YEAR ENDED 31 MARCH 2004

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MANAGEMENT ARRANGEMENTS

Administering Authority Lincolnshire County Council

Pensions Committee Members at 31 March 2004

County Councillors

J Libell (Chairman)
N T Carter OBE
R A Coupland
A Davidson
R A Day DFC
D R Dickinson (Vice Chairman)
C F Fisher
M J Hill
J D Hough
M D Kennedy
R B Parker
Mrs S E Roy
T C Taylor

A H Turner MBE JP
Mrs P F Watson
C B Wood

Lincolnshire Local Government Association

D Hill
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. One special meeting was held in the twelve months ended 31 March 2004 to appoint an investment manager for a portfolio of Fixed Interest securities.

Members of the Committee at 31 March 2004 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. In response to reduced expectations of future returns from equities and the increasing proportion of pensioners in the scheme, Hymans Robertson have advised the Committee to reduce the allocation of investments to equities and increase the amount of Fixed Interest securities. Hymans Robertson also recommended that it would be beneficial to increase the share of overseas equities in the Fund relative to UK equities.

During the year the Committee approved a number of changes to the asset management arrangements, intended to further implement the Actuary's recommendations in respect of the strategic asset allocation. The changes included increasing the Fund's allocation to Corporate Bonds and reducing investments in UK equities.

Fixed Interest Management

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 2004. Following presentations from four investment managers to a special meeting of the Committee and subsequent consideration at a regular meeting of the Committee, Morley Fund Managers were appointed to an expanded Fixed Interest Mandate.

The Committee also approved new arrangements for the management of UK Government Index Linked Gilts by the investment section of the County Treasurer's Office. The small number of such Gilts in issue made internal management on an index tracking basis a practical and cost effective proposition.

HBS bulk transfer

During the year assets with a market value of £13.6 million were transferred from the Fund. The assets reflected the transfer rights of a large number of former Lincolnshire County Council employees who had transferred their pension scheme membership to the HBS pension scheme, as part of the outsourcing of certain County Council services in 2000.

Investment Custodian

The contract with the Fund's long standing investment custodian, Global Investor Services (part of HSBC Bank) ended on 31 March 2004. Following a competitive tendering exercise the Committee appointed JP Morgan Investor Services to a five year contract from 1 April 2004 to provide Global custody services for the Fund.

Training for Committee Members

In line with recommended best practice a series of pensions and investments training programmes have been made available to the members of the Committee. During the year Committee members have attended various introductory, intermediate and comprehensive training sessions delivered by external organisations. A rolling programme of relevant training will be arranged in the future to ensure all Committee members can develop their knowledge of pensions and investment matters.

Pension Scheme Reform

The government continues to consult on the future of the Local Government Pension Scheme. The Committee has spent considerable time developing responses to specific consultations. Forthcoming changes to the LGPS have been broadly welcomed as a means of containing the increasing cost of occupational pension provision. The significant increases in life expectancy and reduced expectations of returns from investment markets will continue to pose significant problems for pension policy makers.

Investment Performance

After three successive years of declining world equity markets, the twelve months ended 31 March 2004 saw very strong returns. Signs of economic recovery around the globe coupled with a swift initial resolution to the invasion of Iraq encouraged equity investors. The Emerging equity and Japanese markets delivered the highest returns for investors at 56% and 46% respectively. Globally, smaller companies and the larger companies who had struggled since 2000 tended to produce returns outstripping those available from more 'blue chip' companies.

The Fund's equity managers generally found it difficult to out perform their respective market indices. In addition, the Fund's asset allocation bias towards the US market and away from Japan and the rest of the Far East was also detrimental to performance. Overall the Fund's actual return of 21% for the year was disappointing when compared with a Benchmark return of 23.9%.

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)

**J LIBELL
CHAIRMAN
PENSIONS COMMITTEE**

The Local Government Pension Scheme (LGPS) is a national scheme administered on a local basis by Lincolnshire County Council, providing current and future benefits for over 38,000 scheme members.

Local Government Pension Scheme membership

Year ended 31 March	2000	2001	2002	2003	2004
Contributors	16,391	16,213	16,817	16,547	18,596
Pensioners	8,820	9,065	9,266	9,486	9,780
Deferred Beneficiaries	5,149	7,298	8,079	8,789	9,800
Total	30,360	32,576	34,162	34,822	38,176

(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. The actual allocation at any point in time reflects the decisions and views of the Fund's investment managers.

Strategic Asset Allocation Benchmark

Asset class	Strategic Benchmark 1 April 2003 to 31 March 2004 %	Actual Asset Allocation 31 March 2004 %
UK Equities	40.0	42.9
North American equities	8.9	13.3
European Equities (ex UK)	8.9	8.2
Japanese equities	3.8	1.0
Pacific equities (ex Japan)	3.8	0.8
Emerging markets	1.6	1.7
Private Equity	3.0	2.2
Total Equities	70.0	70.1
Index Linked Gilts	5.0	4.7
Overseas Fixed Interest	1.5	1.4
UK Conventional Gilts	2.0	1.6
UK Corporate Bonds	10.0	7.6
Total Fixed Interest	18.5	15.3
Property	10.0	11.0
Cash	1.5	3.6
Total	100	100

Investment performance

The twelve months period ended 31 March 2004 saw the value of the Fund increase by £126 million to £746.3m. The investment return of 21% was behind the increase in the Fund's specific benchmark of 23.9%. Over the last ten years, the annualised investment performance of the Fund has marginally exceeded the benchmark with a return of 7% compared to 6.9%.

Annual investment performance over the previous ten years is set out in the table below. The Fund's annual return of 7% compares to increases in both consumer prices (2.7%) and public sector earnings (3.6%).

Investment performance of the Fund 1 April 1994 to 31 March 2004

	Lincolnshire Fund Return	Comparative Benchmark Return	Retail Price Inflation	Public Sector Increase in earnings
	%	%	%	%
1994/95	0.7	2.4	3.5	2.1
1995/96	23.9	23.1	2.7	2.6
1996/97	10.4	12.6	2.6	2.2
1997/98	27.5	25.7	3.5	3.0
1998/99	7.8	9.2	2.1	4.3
1999/00	16.1	15.2	2.6	3.7
2000/01	-8.0	-9.2	2.8	4.4
2001/02	-0.9	-1.2	1.3	4.4
2002/03	-19.3	-22.2	3.1	5.0
2003/04	21.0	23.9	2.5	4.3
10 years annualised	7.0	6.9	2.7	3.6

Investment Management Arrangements

The arrangements for segregated management of the Fund's assets, in place at 31 March 2004, 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	91.1	12.2
Fixed Interest	Lincolnshire County Council	23.0	3.1
	Total Fixed Interest	114.1	15.3
UK Equities	Lincolnshire County Council	194.1	26.0
UK Equities	Deutsche Asset Management	94.5	12.7
Global Equities	Bank of Ireland Asset Management	108.9	14.6
US Equities	INVESCO Asset Management	37.2	5.0
Pan European Equities	Lincolnshire County Council	59.4	8.0
	Total Equities	494.1	66.3

The Fund invests in Emerging Equity Markets, UK Commercial Property and Private Equity by means 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	33.0	4.4
	Standard Life European Property Fund	3.1	0.4
	Deutsche UK Property Funds	20.0	2.7
	Royal London Property Unit Trust	9.5	1.3
	Morley Property Fund	16.2	2.2
	Total UK Property	81.8	11.0
Emerging Markets	Pictet Emerging Markets Fund	13.0	1.7
	Total Emerging Markets	13.0	1.7
Private Equity	Standard Life	3.4	0.5
	Westport Private Equity	11.1	1.5
	Pantheon Private Equity	2.0	0.2
	Total Private Equity	16.5	2.2

Actuarial position

The employers' contribution rates applying in the year ended 31 March 2004, for employers with more than 100 employees participating in the LGPS, are set out below.

Employers' contribution rates 2003/2004

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	290
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 had the right to transfer their accrued pensions to their new employer's scheme. The relevant actuaries agreed that assets of £13.6 million should be transferred during the year to the HBS pension scheme to reflect the value of the transfer elections.

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 2004**

	2003/2004 £000	2002/2003 £000
<i>FUND ACCOUNT</i>		
CONTRIBUTIONS & BENEFITS		
Contributions receivable	45,027	40,732
Transfers in	8,506	8,110
	<u>53,533</u>	<u>48,842</u>
Benefits payable	36,399	34,788
Leavers	17,923	5,843
Administrative expenses	759	642
	<u>55,081</u>	<u>41,273</u>
NET ADDITIONS (WITHDRAWALS) FROM DEALINGS WITH MEMBERS	(1,548)	7,569
RETURNS ON INVESTMENTS		
Investment management expenses	(1,542)	(1,875)
Investment income	24,100	16,497
Change in market value of investments	105,001	(160,889)
NET RETURNS ON INVESTMENTS	<u>127,559</u>	<u>(146,267)</u>
NET CHANGE IN THE FUND VALUE	126,011	(138,698)
<i>NET ASSETS OF THE SCHEME</i>		
OPENING NET ASSETS AS AT 1st APRIL	620,321	759,019
CLOSING NET ASSETS AS AT 31st MARCH	746,332	620,321
<i>NET ASSET STATEMENT</i>		
INVESTMENTS		
FIXED INTEREST SECURITIES	80,024	25,848
EQUITIES	481,484	388,189
INDEX LINKED SECURITIES	34,030	55,794
MANAGED FUNDS AND UNITISED TRUSTS	123,864	105,220
CASH DEPOSITS	6,484	4,651
TOTAL INVESTMENTS	<u>725,886</u>	<u>579,702</u>
CURRENT ASSETS & LIABILITIES	20,446	40,619
CLOSING NET ASSETS AS AT 31st MARCH	<u>746,332</u>	<u>620,321</u>

AUDIT OPINION

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ACTUARIAL STATEMENT

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INVESTMENT BACKGROUND

Returns for major markets

Following three years of negative returns worldwide, equity markets recovered strongly over the twelve months ended March 2004. Sterling investors gained between 16% and 46% from the major equity markets. The US market, where a weak dollar down 14% relative to sterling over the period depressed overall returns for the Fund, achieved the lowest return. The world's emerging equity markets returned 56%.

Fixed Interest markets were subdued as investors focused on higher risk investments. Overseas Bonds produced a negative return of almost 3% and UK Corporate Bonds, Conventional and Index Linked Gilts produced positive returns in the range 2.8% to 6.2%.

Commercial Property in the UK continued to deliver strong overall returns of almost 13%.

Investment Returns to sterling based investors 1 April 2003 to 31 March 2004

Asset Class	Index	Index return to sterling investors %
Equities		
United Kingdom	FTSE All Share	31.0
United States	FTSE North America	16.8
Europe	FTSE Europe (ex UK)	36.9
Japan	FTSE Japan	46.5
Far East	FTSE Pacific (ex Japan)	40.6
Emerging Markets	MSCI Emerging Markets	56.3
Fixed Interest		
UK Index Linked Gilts	FTSE Index – Linked All Stocks	6.2
UK Gilts over 15 years	FTSE All Stocks Over 15 years	2.8
Overseas Bonds	JP Morgan World ex UK	(2.8)
UK Corporate Bonds	ML UK Non Gilts All Stocks	5.1
Property	IPD All Properties	12.9
Cash	Seven Day Rate	3.6

MARKETS OVER THE REPORTING PERIOD

World Equity Markets

- During the year world economies saw an acceleration in economic growth and the return of investors' confidence in equity markets over the year.
- Whilst markets overall produced strong returns, in many cases over 30% or 40%, smaller companies outperformed larger ones by a substantial margin. In the UK the largest 100 companies returned 26%, compared to 63% for the remaining 600 companies represented in the FTSE All Share Index.
- Returns significantly above those of the wider markets were also delivered by technology companies and companies most likely to benefit from an increase in economic activity.
- Stronger global economic growth contributed to significant improvements in company profits.
- The prices of commodities, including oil, increased dramatically due to demand in the US and in particular the rapidly industrialising economies of China and India. The increases prompted concerns about the possibility of higher levels of inflation within the world's economies.
- The turmoil in Iraq and the threat of global terrorism were and remain a constant concern for investment markets.
- Emerging Markets during the year, in local currency terms, almost doubled in value. Attempts, towards the end of the year, by the Chinese government to slow down their rapidly growing economy threatened to undermine the overall recovery in emerging markets.

Fixed Interest Markets

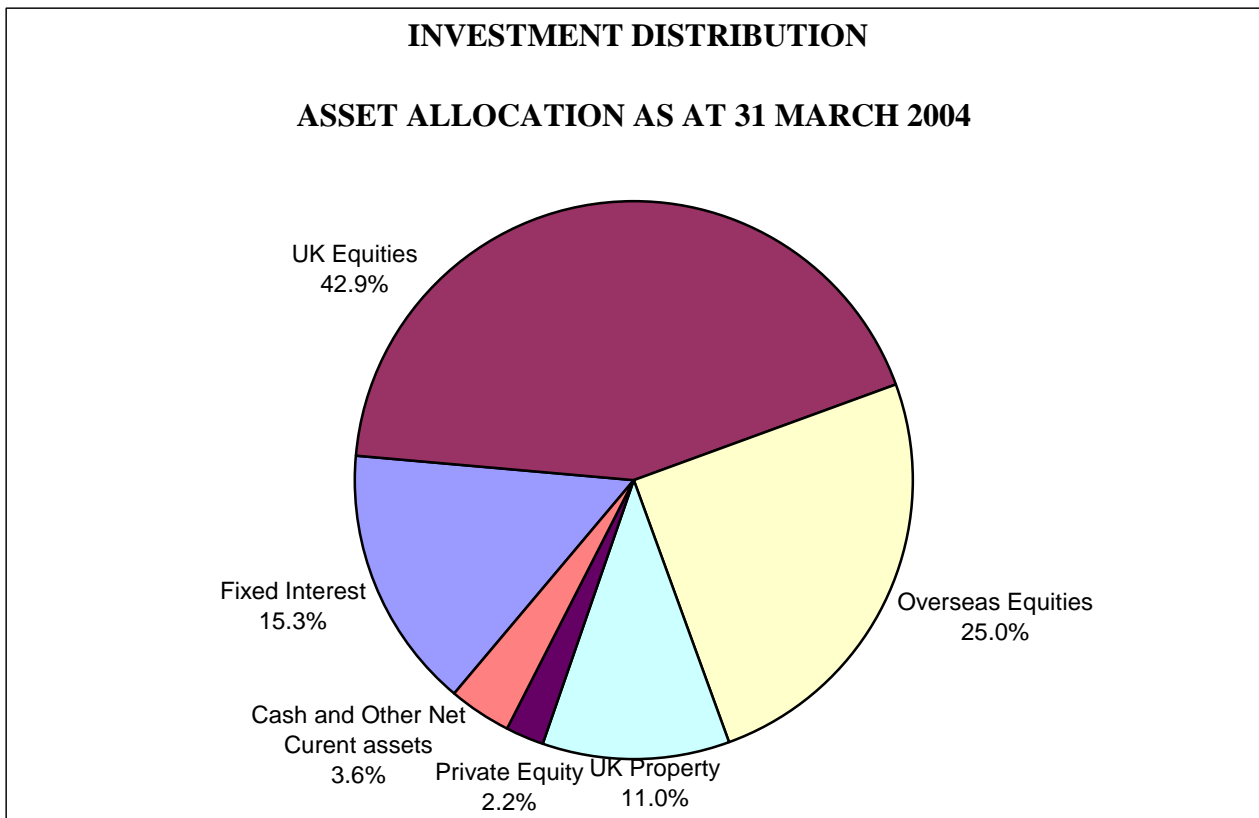
- Fixed Interest markets produced low returns as the likelihood of significant economic growth and associated increases in interest rates drove down bond market prices.
- During the summer the US Federal Reserve reduced the central bank rate from 1.25% to 1% and the Bank of England reduced the base rate from 3.75% to 3.5%, the lowest rates for over 50 years. However, towards the end of the year markets anticipated that interest rates would need to rise to restrain inflation. The Bank of England increased the base rate by 0.25% in both November and February.
- UK Index Linked Gilts were one of the best performing bond markets as investors responded to concerns about future inflation.

Commercial Property

- Overall, Commercial Property in the UK returned 12.9% with retail property, for the second year, benefiting most from signs of economic recovery and high investor demand.
- The retail sector returned some 17%, ahead of industrial and office properties providing 13% and 6% respectively.
- As witnessed by the returns achieved, competition for the relatively small amount of investment properties coming onto the market was intense.

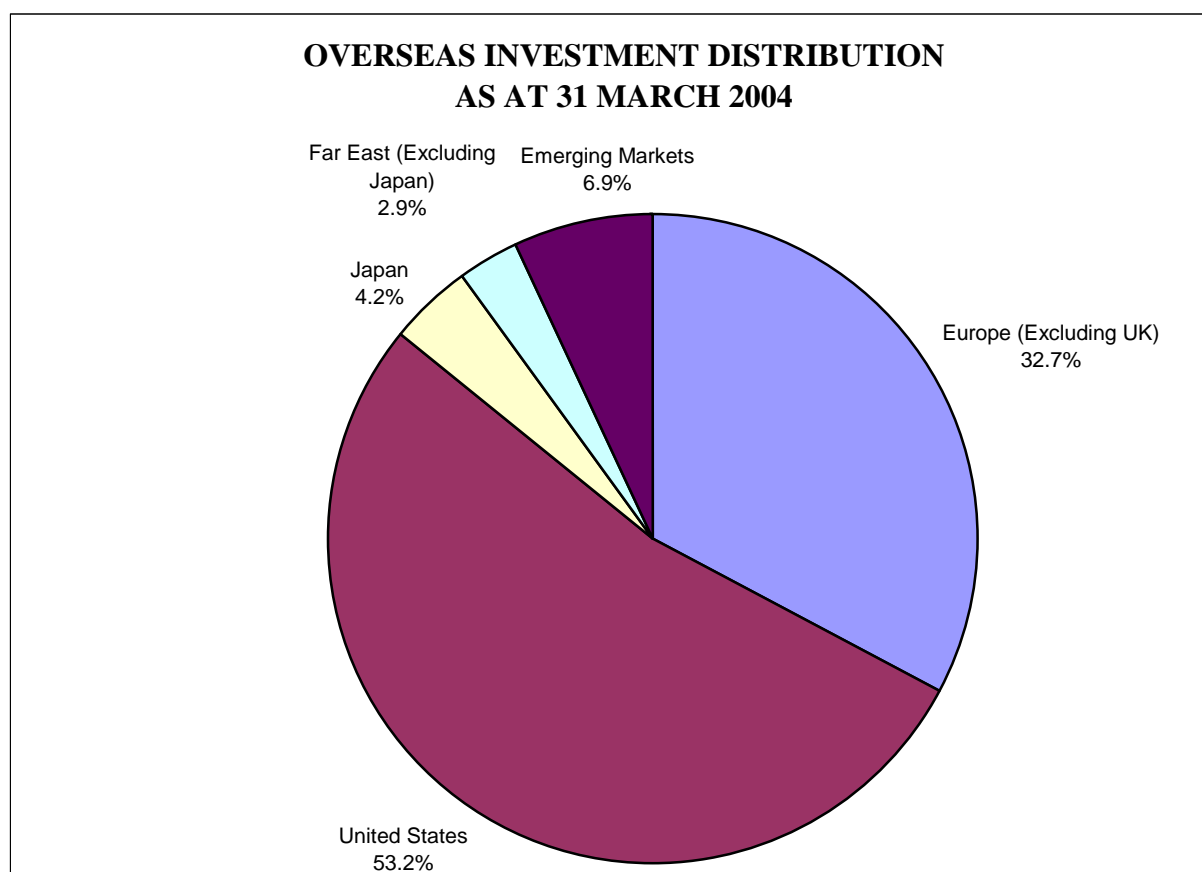
ASSET DISTRIBUTION AT 31 MARCH 2004

Asset class	Market Value £000	31/3/04 %	31/3/03 %
Fixed Interest	114,054	15.3	13.2
UK Equities	320,398	42.9	42.7
Overseas Equities	186,641	25.0	22.9
UK Property	81,819	11.0	12.0
Private Equity	16,490	2.2	1.9
Cash & Other Net Current assets	26,930	3.6	7.3
Total	746,332	100.0	100.0



OVERSEAS EQUITIES ASSET DISTRIBUTION AS AT 31 MARCH 2004

Asset class	Market Value £000	31/3/04 %	31/3/03 %
Europe (Excluding United Kingdom)	61,041	32.7	28.8
United States	99,331	53.2	59.4
Japan	7,805	4.2	3.4
Far East (Excluding Japan)	5,500	2.9	2.4
Emerging Markets	12,964	6.9	6.0
Total	186,641	100.0	100.0



TWENTY LARGEST HOLDINGS IN THE FUND AS AT 31 MARCH 2004

	Market Value £000	Proportion of Fund %
Standard Life UK Property Fund	32,991	4.4
HSBC Holdings	23,261	3.1
BP	21,369	2.9
Vodafone	21,339	2.9
Deutsche UK Managed Property Fund	19,836	2.7
Glaxo Smithkline	16,221	2.2
Morley Property Fund	16,205	2.2
Royal Bank of Scotland	13,613	1.8
Astrazeneca	11,725	1.6
Shell Transport & Trading	10,290	1.4
Royal London Exempt Property Unit Trust	9,482	1.3
Barclays	6,381	0.9
Treasury 2.5% Index Linked 2013	6,059	0.8
Treasury 2.5% Index Linked 2016	5,602	0.8
Altria Group	5,354	0.7
Gannett	5,337	0.7
Treasury 2.5% Index Linked 2024	5,269	0.7
Treasury 2.5% Index Linked 2020	5,161	0.6
Treasury 2.5% Index Linked 2011	5,085	0.6
Westport European Private Equity Programme	5,053	0.6
Total	245,633	32.9

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 2004

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
Heritage Trust for Lincolnshire
Lincolnshire Tourism
Lincolnshire Trust for Nature
Linx Homes
Sleaford Development Group