HYMANS ROBERTSON

Briefing note

2025 LGPS valuations: insights into emerging results

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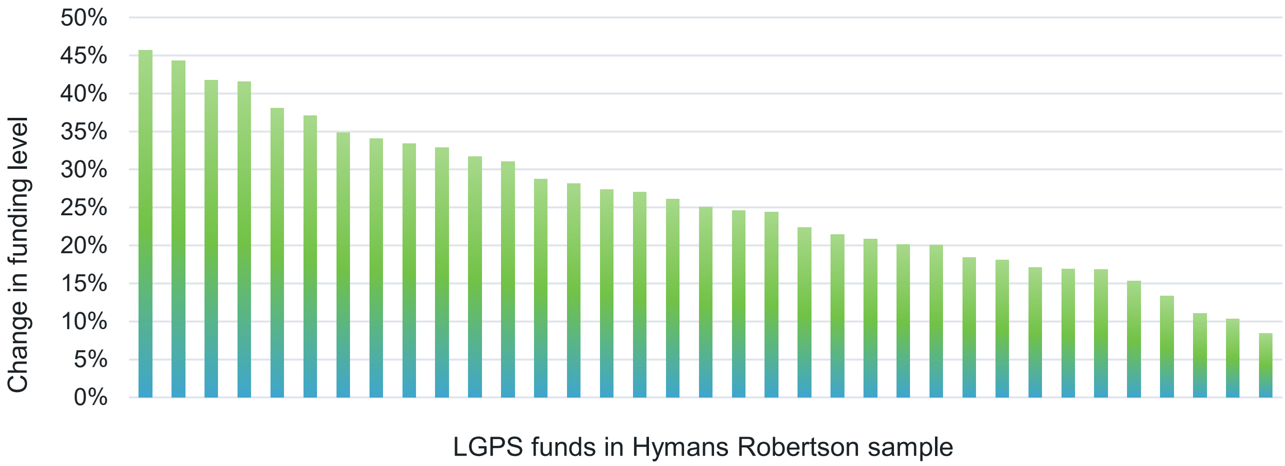
The LGPS in England & Wales is nearly halfway through the 2025 valuation year and, after much planning, initial funding results are starting to emerge. As well as getting a better picture of the funding position of the LGPS at 2025, we've provided insight into the key factors that will be driving how it's changed since 2022 and its variation across funds at 2025[1].

Improvements in funding?

At the time of writing, Hymans Robertson has carried out initial valuation calculations for 35 LGPS funds. The chart below details the absolute change in funding level for each of these funds between 2022 and 2025.

Change in funding level since 2022 valuation



The question you might now be asking is why aren't they all the same? The answer requires some deeper digging.

[1] All figures and analysis in this report are based on a representative sample of the LGPS funds where Hymans Robertson is the Fund Actuary

Known events since 2022

At the 2022 valuations, every LGPS fund made assumptions about the future. How actual experience compares to these assumptions will shape how each fund's funding position evolves over time. Areas of particular interest at 2025 are around investment returns, inflation and membership experience. However, in terms of funding impact, the biggest factor will generally be investment returns.

Investment returns

There are a variety of investment strategies adopted by LGPS funds. This is a good thing. It reflects that funds are making their own decisions about what is an appropriate investment strategy for funding a long-term, open defined benefit scheme (there is no perfect or correct strategy).

This does lead to variation in investment returns between funds, particularly over shorter periods – and 3 years is a short period in the context of long-term investing. In general, from the funds in our sample, investment returns have just about kept pace with the average level of return assumed at 2022 (which was around 4.3% pa). Some funds have performed better than others, however it's difficult to draw too many conclusions without recognising the different strategies and risk appetites of the funds.

Furthermore, for such a long-term scheme, drawing conclusions about relative performance over a short 3 year period is unwise. For any long-term investor (such as the LGPS), the focus should always be on the longer-term – and in this regard the LGPS is a strong performer, achieving around 7.5%-8% pa over the past 30 years according to the E&W Scheme Advisory Board's 2024 annual scheme report.

Inflation

High inflation has been in the headlines since 2022. This has led to significant increases to benefits in the LGPS with pensions going up by 10.1% in 2023 and a further 6.7% in 2024 (with increases based on Consumer Price Inflation). However, much of this was predicted at 2022 and these high realised increases have been largely offset by lower expectations about the future (since these big spikes in 2022 and 2023 are now in the past).

Membership experience

Given the big changes in the economic environment since 2022, the impact of actual membership experience pales in significance at 2025. That being said, the valuation provides an opportunity to analyse trends and adjust assumptions about the future. Items of interest from the emerging data include:

- LGPS continues to grow with membership numbers up across the board. The scheme also continues to mature which places additional importance on careful cashflow management.
- Salary increases in our sample have been around 6% pa which means they have only just kept pace with CPI inflation, diluting any financial impact of the McCloud underpin.
- Longevity analysis shows slightly lower mortality amongst pensioners than expected, suggesting some sort of bounce back post-pandemic

Changes in future expectations

LGPS funds need to make assumptions about the future to assess the potential size and timing of future benefit payments. The most material assumptions are around future inflation, longevity and investment returns (also referred to as the discount rate). We'd generally expect not too much variation between LGPS funds around inflation and longevity, however the same can't be said for investment returns. At the 2025 valuations there is a significant amount of debate and uncertainty about what the change in the economic environment since 2022 (typified by increases in global interest rates) will mean for future investment returns.

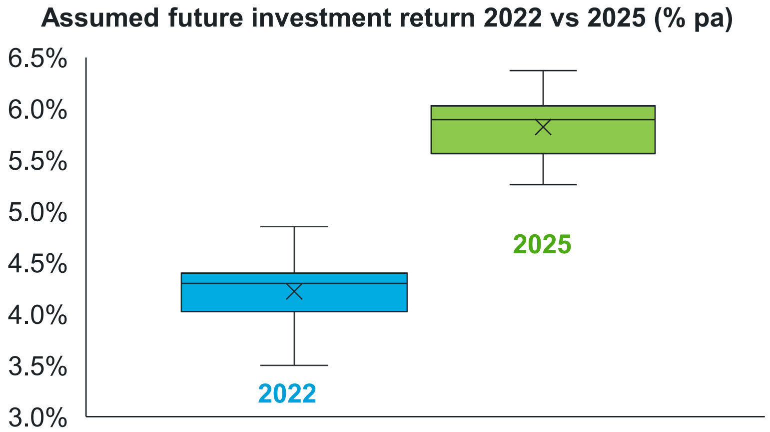
For example, we're now in a position where the average LGPS discount rate at the 2022 valuation (4.3% pa) is significantly lower than the market's long-term 'risk-free' rate of return (over 5% pa at March 2025). Does this mean that the future investment returns should increase, as investors should expect to be compensated with higher returns for taking investment risk with assets such as equities and property? Or are long-term returns still going to be around the same level as 2022, in which case why hold those riskier investments when a fund could get a better rate of return in lower-risk assets?

A poll of nearly 100 attendees at our recent 2025 valuation focussed webinar[2] demonstrated this uncertainty around the future investment return assumption, with a range of beliefs evident from those polled:

What do you think is a prudent estimate of future investment returns over next 20 years (% pa)?

<4% pa	4% to 5% pa	5% to 6% pa	6% to 7% pa	>7% pa
3%	**44%**	**42%**	**10%**	**1%**

For the LGPS funds in our sample, we're typically seeing an increase in the level of future assumed investment returns, relative to the 2022 valuation. The 'box and whisker' chart opposite shows their distribution.



- The end points (the 'whiskers') show the spread of assumptions at each date. In both cases this spread is around 1.5% pa between the highest and lowest assumed return. This will be due to a combination investment strategy, risk appetite and beliefs about the future being varied across funds.
- The 'box' shows the middle two quartiles (50% of funds sit in the box) and the horizontal line through the box is the median (the average) across all funds at each date. This average expected future return is rising from 4.3% pa at 2022 to around 5.9% pa at 2025. This change will result in lower values being placed on liabilities and improvements in funding levels. However, the magnitude of the increase in assumed returns is much less than the equivalent increase in the market's 'risk-free' rate of return since 2022 (from around 1.7% pa at 2022 to 5.2% pa at 2025). This suggests that funds are aware of the uncertainty around the investment outlook and are ensuring that their future investment return assumption has an appropriate margin of prudence to avoid storing up any problems for the future.

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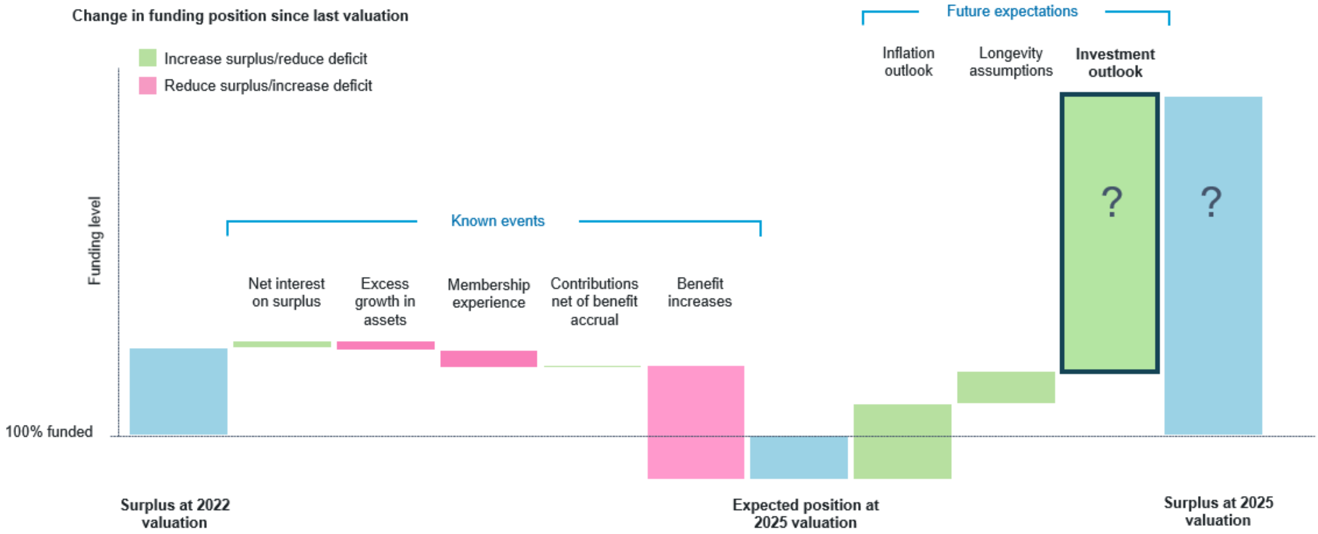
[2] Recording of this webinar can be accessed here

Pulling it all together

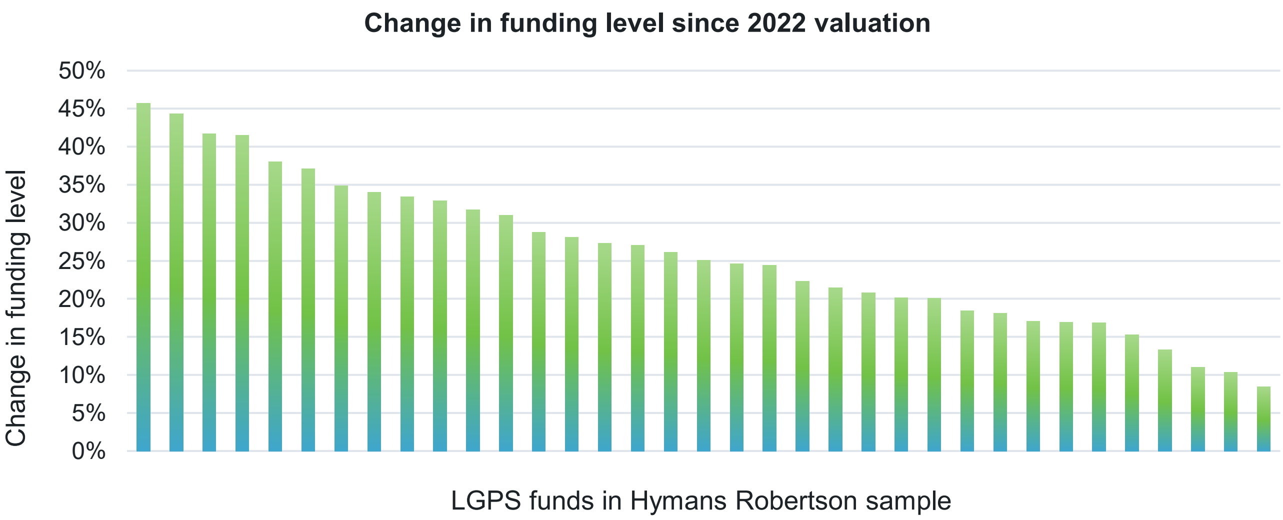
The chart below for a sample LGPS fund shows the main factors that have contributed to the change in its funding position from 2022 to 2025.



Funds' beliefs on future investment returns could have a big impact at this valuation. Based on the analysis that is emerging, we expect that there will be more variance across funds than usual at 2025. This will likely result in more variance in funding level changes between 2022 and 2025 and in the absolute funding levels for LGPS funds.

LGPS funds need to put a single value on what they think future investment returns will be following a very short, sharp change in the economic environment and significantly increased levels of market and economic volatility. This is difficult and there is no right answer. In our experience, LGPS funds are considering this decision with a high level of diligence and care. The fact that different funds come up with a different single value at 2025, which will drive funding level variation, is a sign of good governance.

The chart below (which we saw earlier) details the absolute change in funding level for the 35 funds in our sample and demonstrates this variance.



Generally, we're seeing improvements in funding levels, a similar story to that in the private sector pension environment. The cause of these improvements, which in some cases are significant, is because of a change in the level of expected future investment returns, ie **returns that funds have not yet earned**. And so, since these returns have not yet been 'banked', funds have been very careful to not directly translate these improvements in funding level to significant reductions in employer contribution rates. Our recent Briefing Note shares insights into the level of reduction of contribution rates at the 2025 valuation for local authorities.

We would urge similar caution to other stakeholders in the LGPS to not read too much into these funding level improvements and suddenly expect large changes in contribution rates or believe that the LGPS has a significant amount of surplus funding. A funding level is after all a single estimate on a particular day. They can be volatile and are very sensitive to market fluctuations and beliefs about the future. Most importantly, they don't take into account the cost of future benefits and all the other particular nuances that are needed when setting long-term funding strategies for a long-term open defined benefit pension scheme like the LGPS.

Final reflections

The LGPS is a long-term, open scheme that continues to grow and accrue benefits meaning that longer-term strategy should arguably be a more important focus than funding levels on any given day. Every fund in our sample has considered this same problem and come up with the same answer: to have a strategy that focuses on the longer-term to achieve the best outcomes for all stakeholders.

So, in that regard – maybe they are all the same after all.

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