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60-second summary

Managing cashflows in the LGPS

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It is becoming increasingly important for LGPS funds to manage cashflows carefully due to evolving economic, demographic and regulatory factors. This briefing sets out the key drivers of cashflow changes, implications of cashflow negativity, and how LGPS funds can ensure they meet emerging pension obligations.

Background

Until recently, most LGPS funds had been in a net positive cashflow position – contribution income from members and employers was more than enough to cover pension benefit payments. However, the position has now shifted, with many funds now in a net negative cashflow position or expected to be so soon.

Having negative cashflow is not unexpected given the changing demographic profile of the LGPS. After all, funds' assets are accrued for the purpose of paying benefits. A fund's liquidity requires careful monitoring to ensure pension benefits are always paid on time, including the realisation of income from assets.

Key drivers of changes to the cashflow position

- **Pension Increase Orders:** LGPS benefits rise annually in line with the Pensions Increase (PI) Order, which is based on the change in the Consumer Prices Index (CPI) over the 12 months to the previous September. Recent years have seen exceptionally high PI Orders which have significantly increased benefit payments. Benefits are expected to increase by a further 3.8% in April 2026.

- **Contribution rate reductions:** The 2025 valuation has led to lower employer contribution rates for most employers, reducing the income received by funds and increasing the gap between contributions and pension payments. This trend may push some funds into a cashflow negative position for the first time.

- **Demographic shifts:** As the LGPS matures, the proportion of pensioners and deferred members increases relative to active contributors, naturally reducing contribution income and increasing benefit outgo.

Implications of cashflow negativity

- **Income generation:** When an LGPS fund is in a negative cashflow position, reliance is placed on investment income to meet benefit payments. Understanding the level of income required to meet pension payments is important, as is understanding the effect of any changes to the investment strategy (to generate the required income) on long term returns and the knock-on impact on the valuation assumptions and contribution rates.

- **Operational risks:** If a fund does not manage a negative cashflow position, it may be forced into a position where assets need to be sold to meet pension payments. A sufficient proportion of an LGPS funds' assets are marketable, but selling at the wrong time can disrupt investment strategy and reduce long-term returns.

- **Reputational risks:** The primary objective of an LGPS fund is to pay pension benefits to members on time. Proactive cashflow analysis helps funds to avoid surprises and ensure they have sufficient liquidity to meet obligations. Without this, there is a risk of delayed pension payments to members.

Best practices for managing cashflow

- **Annual projections:** Use up-to-date data from the latest valuation and incorporate current inflation scenarios to model future cashflows accurately.

- **Support for asset pools:** As asset pools take on greater responsibility for managing LGPS assets, including some cash, LGPS funds should provide clear cashflow projections to help pools manage liquidity risks during periods of transition. Pools also need to develop the capability to provide this efficiently.

- **Buffer for private market calls:** Investments in private equity and other private markets may require sudden cash calls. Maintaining a liquidity buffer ensures funds can meet these obligations without disrupting pension payments.

- **Monitoring the impact of Local Government Reorganisation (LGR):** Combining authorities into unitary bodies may reduce the workforce and, consequently, contribution income. Affected funds in England should monitor these changes and adjust cashflow projections accordingly.

- **Review prepayment policies:** Some employers may prepay contributions upfront that were otherwise due for collection over a longer period. The impact of this on the cashflow position should be assessed.

- **Investment strategy adjustments:** If cashflow negativity persists or worsens, funds may need to revise their investment strategies to generate more income, balancing liquidity needs with long-term growth objectives.

Conclusion

Managing cashflow in the LGPS is a growing challenge requiring annual analysis, scenario planning, and strategic adjustments. However, by understanding the drivers of cashflow changes and proactively addressing risks, LGPS funds can maintain financial stability and continue to reliably meet their pension obligations. Regular monitoring is key to navigating the evolving landscape and to ensure that pension benefits will always be paid in full and on time

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