

Non-Executive Report of the: Pensions Committee Monday, 11 November 2024	 TOWER HAMLETS
Report of: Julie Lorraine, Corporate Director, Resources	Classification: Restricted (Exempt)
Liquidity and Cashflow Monitoring – September 2024	

Originating Officer(s)	Paul Audu, Head of Pensions and Treasury (Interim)
Wards affected	All

Executive Summary

This report informs the Pensions Committee on the Pension Fund liquidity and cashflow forecast 2024/25 to 2025/26. The cashflow covers a two-year cycle from 2024 to 2026 with a focus on 2024/25 and subject to quarterly reviews and updates. The Fund is forecasting a £10.6 million positive net cashflow by 2025/26 without divesting from investments. The forecast position with respect to 2024-2025 is reporting a £2.5m surplus. This assumes that the remaining 6 months of the year there will be no divestments or capital calls.

Recommendations:

The Pensions Committee is recommended to:

1. Note the Pension Fund liquidity and cashflow forecast 2024/25 to 2025/26 appended to this report (**Appendix 1**).

1. **REASONS FOR THE DECISIONS**

- 1.1 The Local Government Pension Scheme (LGPS) is undergoing unprecedented change and challenges. It is imperative that Tower Hamlet Pension Fund plans and operations are underpinned by sufficient resources and effective financial management.
- 1.2 A key aim and objective, from a funding and investment perspective, is to ensure that net cash outgoings can be met as and when required. This requires consistency between the agreed funding strategy and investment strategy.
- 1.3 The long-term investment objectives of Tower Hamlets Pension Fund are to invest to meet the cashflows of the Fund's liabilities using a diversified portfolio of assets; to limit the risk of assets/liabilities shortfall; and to ensure the Fund's assets have sufficient liquidity.

- 1.4 Tower Hamlets Pension Fund's strategic objectives and the asset allocation benchmark are reviewed at least once every three years with the latter driven by the financial characteristics of the Fund, including its liabilities, strength of employers' covenant and risk tolerance.
- 1.5 The income and liquidity profile of the Fund is designed to ensure adequate liquid assets are available to meet benefit payments as they crystallise. The investment strategy is not geared to be a perfect match for the Fund's liabilities due to the Scheme being open, availability of matching assets, and uncertainty of future payments linked to non-financial factors such as members' longevity.

2. ALTERNATIVE OPTIONS

- 2.1 LGPS Funds have a relatively long investment horizon affording them resilience in periods of high volatility. Also, they receive regular contributions that are not subject to investor redemptions.
- 2.2 The LGPS is largely well-funded compared to the private sector DB schemes that are predominantly closed and significantly more mature. There is the view that the LGPS can improve the long-term financial stability of employers via bigger risk appetite for illiquid but potentially higher-return investments.
- 2.3 The performance of the Pension Fund assets has an impact on employers' contributions. The Fund is required by law to ensure that members' benefits, enshrined in statute, are paid as they fall due, regardless of the performance of the Fund's investments.

3. DETAILS OF THE REPORT

- 3.1 The primary funding objective is the long-term solvency of the Pension Fund, ensuring that sufficient funds are available to always meet the Fund's obligations. The LGPS Scheme Advisory Board (SAB) analysis of LGPS Funds in England and Wales as at 31 March 2023 suggests that pension contributions (£12.07bn) fell short of benefit payments (£13.0bn) which is consistent with a maturing scheme.
- 3.2 Defined Benefits (DB) schemes are becoming more mature due to more members retiring, and benefits outflows are increasing rapidly, thus making cashflow management a key issue. Pension Funds that are cashflow negative are at risk of being forced to sell assets at the wrong time and at disadvantageous prices to meet their liabilities, crystallising the loss to the detriment of the Fund in terms of additional funding shortfalls.

- 3.3 Tower Hamlet Pension Fund's membership profile for the last 5 years is summarised in the table below.

Membership	2019/20	2020/21	2021/22	2022/23	2023/24
Actives	7,120	7,230	7,652	7,757	8,112
Deferred	7,845	7,993	8,321	8,398	10,875
Pensioners	6,660	6,698	6,979	7,186	7,311
Total	21,625	21,921	22,952	23,341	26,298

The above table shows a maturing trend albeit the cashflow position remains positive.

- 3.4 The liquidity requirements of pension schemes vary and the dynamics of individual pension fund's cashflows are unique depending on the employers' financial circumstances and Fund's investment arrangements. LGPS Funds have distinct liquidity considerations compared to their corporate Defined Benefits (DB) peers. In September 2022, UK corporate DB schemes experienced liquidity challenges due to sudden rise in yields which triggered collateral calls, forcing schemes to sell assets quickly. Schemes that are heavily exposed to illiquid assets are prone to distress. LGPS Funds are less exposed to liability-driven investment (LDI) risk.
- 3.5 The opportunity costs of holding cash are high. The hunt for yield is driving LGPS Funds towards alternative assets, often illiquid. LGPS Funds require liquidity for pension payments and capital calls. Tower Hamlets Pension Fund has no explicit allocation to cash in its strategy. This implies that the Fund is fully invested. Therefore, holding excessive cash would be inconsistent with the strategy and potentially detrimental to performance.
- 3.6 Tower Hamlets Pension Fund has a diversified investment portfolio, balancing liquid and illiquid assets with uncorrelated strategies to mitigate risk from a cashflow or rebalancing viewpoint. The Fund's liquidity profile is carefully managed giving regard to both short-term obligations and strategic investment goals. This approach helps to balance liquidity needs and long-term investment opportunities effectively. In general, the Fund invests in assets that are realisable at short notice.
- 3.7 The Pensions Committee last reviewed the Pension Fund liquidity and cashflow forecast at its meeting on 30 September 2024.
- 3.8 Officers regularly review cashflow requirements, including benefit payments, administrative costs, and capital calls. The Fund's investment consultants make cashflow projections to allocate assets and manage liquidity needs by evaluating how different market scenarios impact liquidity.
- 3.9 The Fund ensures cost saving via pooling and good cashflow management including planning for benefit payments and optimum investment rebalancing, holding sufficient cash buffer to avoid a drag on investment returns and maintaining resilient investment strategy in line with the Fund's needs.

- 3.10 The cashflow of the Fund is presented in **Appendix 1**. It shows the projected cash position for the current year and the next two years. The main inflows and outflows are contribution income and benefits payable respectively. They determine the current position of the Fund in the maturity spectrum and when the Fund is likely to reach maturity and be cashflow negative.
- 3.11 The forecast for contributions is based on the employers' contribution rates in the Rates and Adjustments Certificate (RAC) from the 2022 triennial actuarial valuation. The rates are based on a pay increase of 2.8% per employee in 2023/24. The contributions for subsequent years have been increased in line with the RAC and itself consistent with the Funding Strategy Statement dated March 2023.
- 3.12 The forecast for pension benefits payments is based on Hymans assumptions on increases in pensioners and inflation. Pensioner numbers have been uplifted by about 3% based on historic and current trends. For inflation, the CPI Pension Increase Rate of 1.7% at 30 September 2024 has been used to increase benefit payments from April 2025.
- 3.13 The overall cashflow position is forecast to remain positive in 2025/26 with a net position of £10.6 million up from £1.3 million in 2023/24 on a prudent basis. The net cash position in 2025/26 assumes higher contributions in 2025/26 and nil internal cash used to fund capital calls. Of course, the values are subject to change.
- 3.14 The Fund was 123% funded at the 2022 Actuarial Valuation. The estimated funding level at 30 September 2024 has risen to 163%. At the next triennial actuarial valuation at 31 March 2025, the solvency level and new contribution rates will be determined, and a rates and adjustments certificate will be provided to take effect from 1 April 2026. Officers will request Hymans Robertson, the Fund Actuary, to prepare a cashflow model for the Fund for the ensuing three years. The model will be extended to include forecast operating expenses for the period.

4. EQUALITIES IMPLICATIONS

- 4.1 There are no specific equalities implications that are either not covered in the main body of the report or are required to be highlighted to ensure decision makers give them proper consideration.

5. OTHER STATUTORY IMPLICATIONS

- 5.1 There are no specific statutory implications that are either not covered in the main body of the report or are required to be highlighted to ensure decision makers give them proper consideration.

Risk Management

- 5.2 Section 249A of the Pensions Act 2004 requires the administering authority to manage risk by establishing and operating internal controls which are adequate for the purpose of securing that the scheme is administered and managed:

- (a) in accordance with the scheme rules
- (b) in accordance with the requirements of the law.

5.3 Any form of investment inevitably involves a degree of risk. To minimise risk, the Pensions Committee attempts to achieve a diversified portfolio. Diversification relates to asset classes and management styles.

6. COMMENTS OF THE CHIEF FINANCE OFFICER

6.1 Finance comments are included in the report.

6.2 The employer's contribution is a significant element of the Council's budget and consequently any improvement in investment performance will reduce the contribution and increase the funds available for other corporate priorities.

7. COMMENTS OF LEGAL SERVICES

7.1 The Council as administering authority of the pension fund must ensure that it complies with its statutory duties in relation to the proper management of the pension funds. It is necessary and appropriate for the Pensions Board to receive information on the performance of the Fund in relation to the liquidity as set out in this report.

Linked Reports, Appendices and Background Documents

Linked Report

- NONE

Appendices

- Appendix 1 – Pension Fund Liquidity and Cashflow Forecast 2024/25 to 2025/26

Local Government Act, 1972 Section 100D (As amended)

List of "Background Papers" used in the preparation of this report.

- NONE

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Appendix 1: Pension Fund Cashflow 2024/25 – 2025/26

	2024/25 Actuals to September £'000	2024/25 Forecast £'000	2025/26 Forecast £'000
CASH IN			
Contributions			
From Employers	-47,892	-49,500	-52,000
From Employees	-17,064	-17,497	-18,372
Payment of Deficit Contributions	-13,677	-13,650	-13,650
Augumentation	-61	-2,000	-2,000
Transfer Values In	-2,862	-10,400	-11,300
Other Income			
From Returned Pensions Payroll Bacs	-7	0	0
From Pensions over payments and returned bacs	-422	-424	-140
AVC in	-35	-26	-40
Income from Recoverable Taxes	0	0	0
Intransit payments	0	0	0
VATrefund	0	-240	-285
Reimbursement of Council Overseas Pensioners	0	0	0
Income from Fund Manager Fee Rebates	0	-60	-60
Interest Receivable (LCIV UK Housing Fund - (Catch-Up Interest))	0	0	0
	-82,020	-93,797	-97,847
Cash from divestments (LCIV UK Housing Fund - Equalisation (Return of Capital))	-16,211	-897	0
TOTAL CASH IN	-98,231	-94,694	-97,847
CASH OUT			
Benefit Payable	54,173	59,533	60,545
Lump Sums, Retirement Allowances & Death Grants	36	15,077	16,077
Payment to and on account of leavers			
Refund of Contributions	41	308	308
Transfer Values Out	5	9,448	9,448
Other Miscellaneous Payments	37,219	0	0
Capital Calls funded with inhouse cash	5,667	5,667	0
Expenses			
Fund manager fees paid in house	0	1,144	1,144
Admin Expenses	1,076	1,754	1,754
Oversight and Governance fees	0	511	511
Previous Year's recharges paid	0	0	0
	98,217	93,440	89,787
NET INCOME/ EXPENDITURE	-14	-1,253	-8,060
Opening Cash balance	-1,246	-1,246	-2,499
Net Cash Movement	-14	-1,253	-8,060
CLOSING CASH POSITION	-1,260	-2,499	-10,559