HYMANS ROBERTSON

London Borough of Hackney Pension Fund

Cashflow projections

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For and on behalf of Hymans Robertson LLP

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Executive summary

This paper is addressed to London Borough of Hackney as the Administering Authority to the London Borough of Hackney Pension Fund ("the Fund"). The paper considers different future projections of the Fund's cashflows under a range of different scenarios. The analysis and projections will help the Fund better understand its current and potential future cashflow position and is part of its management of risk in this area.

From the analysis and projections set out in this paper, the following conclusions can be drawn:

In the absence of investment income, the Fund is likely to be cashflow negative by the 2027 after recognising the proposed reductions in contribution rates that have been agreed as part of the 2025 valuation and inflation in line with the general consensus for future inflation outlook. This is earlier than previously anticipated as part of the analysis carried out in February 2025, where the Fund was expected to become cashflow negative by 2032.

The cashflow position of the Fund is sensitive to future levels of inflation. The weak demand-driven inflation scenario represents a period of "low inflation" as the government embarks on fiscal consolidation through tax increases and spending cuts. Under this scenario, the Fund's cashflow position is improved due to salary increases exceeding inflation, however the position remains negative for most of the period. This highlights the importance of reviewing the cashflow position on a regular basis in an uncertain inflationary environment.

In the longer-term, the most significant risk to the Fund (in respect of its cashflow position) is a structurally higher inflation scenario, where inflation remains elevated for a longer period of time and the growth in payroll (and hence subsequent contribution income) does not keep pace. Under this scenario, the Fund's cashflow position is significantly worse, with the gap between contribution income and benefit outgo increasing to a material level in the longer-term.

The Fund's cashflow position is also sensitive to a number of other factors. The Fund should closely monitor their short term cashflow requirements to ensure that benefits can be paid in any future scenario.

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Background and Inputs

What is cashflow negativity and does it matter?

Every month, the Fund receives income via contributions and pays out benefits to members. Historically, the benefits have been paid out of the contribution income with any excess being invested. This is how the Fund's asset value has built up over time (along with investment returns).

Over time a pension fund will mature, and the level of benefit payments will start to exceed contribution income. At this point, a pension fund is considered "cashflow negative".

Being cashflow negative itself is not unexpected for a pension fund; the assets that have been accrued are for the purpose of paying benefits. However, if the transition to being cashflow negative is not monitored and managed effectively, it can pose a liquidity risk and the Fund may become a forced seller of assets.

At the 2025 valuation, there is a greater focus on cashflow. Improved funding positions mean that most employers will receive reductions in contribution rates from 1 April 2026, reducing the cash available to make benefit payments.

Knowing when the Fund is likely to be cash flow negative is helpful as it can have implications for both the funding and investment strategy:

1. Having cash available to meet the Fund's primary objective of paying member benefits
2. The ability to maintain stable contributions over time and withstand volatility from investment markets
3. Understanding the level of cash balance that needs to be retained while avoiding a drag on investment returns
4. Avoiding the risk of being a forced seller of assets at inopportune times
5. Making the most efficient use of income generated by Fund assets
6. Implementing optimum rebalancing and cash management policies

This paper explores the Fund's cashflow position under different scenarios to inform the approach to cashflow management

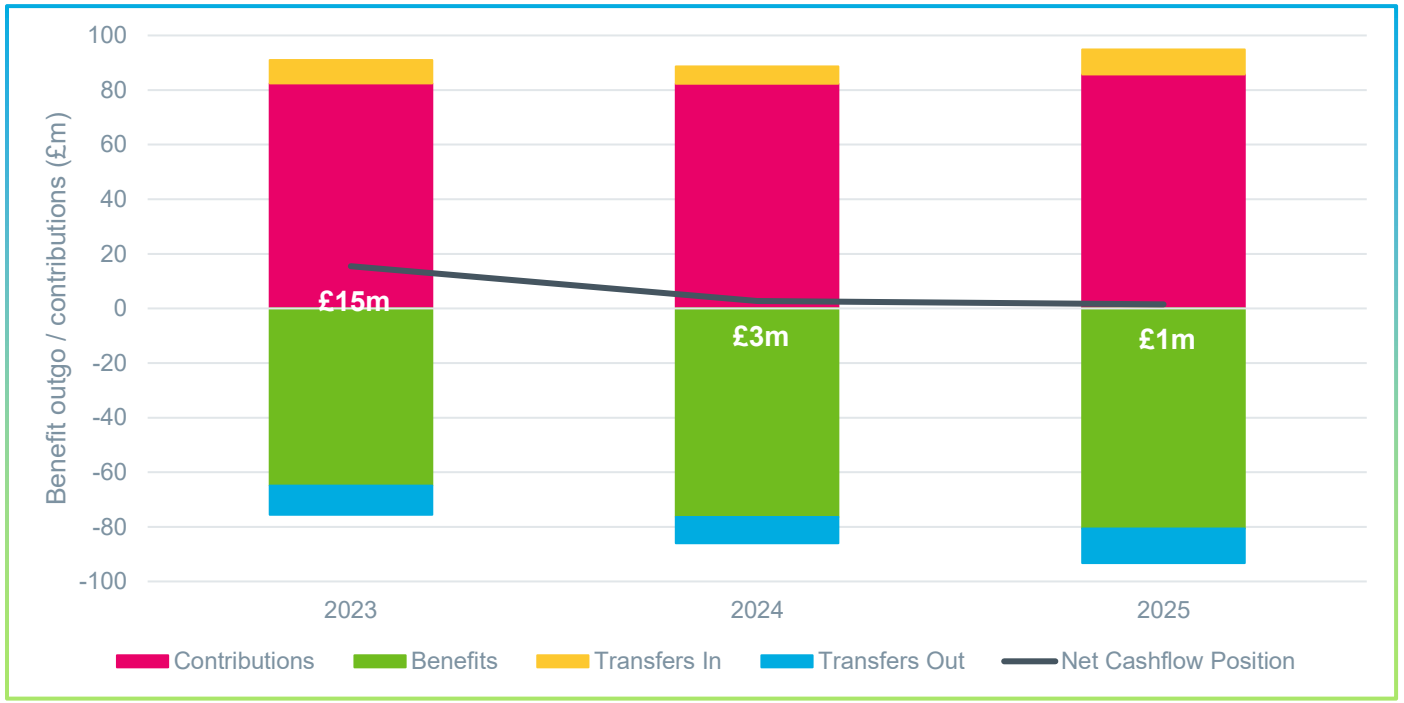
Recent cashflow position

Using the annual report and accounts for years ending 2023, 2024 and 2025, we have analysed the recent cashflow position for the Fund.

The chart shows the absolute value of contribution income and benefit outgo (bars) and the net cashflow position (line and figures).

The Fund was cashflow positive for all three years i.e. contribution income exceeding benefit outgo.

However, the magnitude of benefits in payment by the Fund is continuing to increase on an annual basis. With contribution income expected to reduce as a result of contribution rate reductions at the 2025 valuation, the Fund's cashflow position may change significantly in a short period of time.



The cashflow position has remained positive in all three years since the 2022 valuation. However, the Fund is moving towards a cashflow negative position, therefore increases in benefit outgo and decreases in contribution income may alter the position in a short period of time.

What are the cashflows of the Fund

In this paper we consider the main cashflows in and out of the Fund over the next 20 years.

The Fund's primary sources of income are:

- Contributions from employers in the Fund
- Contributions from employee members in the Fund
- Income streams generated from the Fund's investments

Contributions paid are estimated based on:

- Payroll based on membership data as at 31 March 2025
- The 2025/26 contribution rates as certified in the 2022 valuation Rates & Adjustment Certificate (equivalent to an average of 26.1% of pay).
- The proposed contribution rates for the period 1 April 2026 to 31 March 2029, as agreed as part of the 2025 valuation (equivalent to an average of 21.8% of pay).

The Fund's outflows are the benefits payable to the members and their dependants. These include:

- Retirement lump sums paid to active and deferred members on retirement
- Retirement pensions paid to pensioners and their dependents
- Death in service benefits and ill health benefits.

Transfers in and out of the Fund by individual members are not usually a significant source of income or outflow and typically balance out over time.

The projected cashflows are sensitive to a number of assumptions. The most significant are:

- Level of future benefit increases (all LGPS benefits are index-linked and increase in line with Consumer Price Index (CPI) inflation)
- Level of current and future payroll (determines the amount of contributions received)

We have prepared future cashflow projections under a range of different inflation scenarios to inform decision making.
This helps the Fund understand the sensitivity of its cashflow position to these sources of uncertainty and make appropriate management plans.

Data, assumptions and methodology

Membership data

We have used the membership data as at 31 March 2025 provided for the 2025 formal valuation of the Fund.

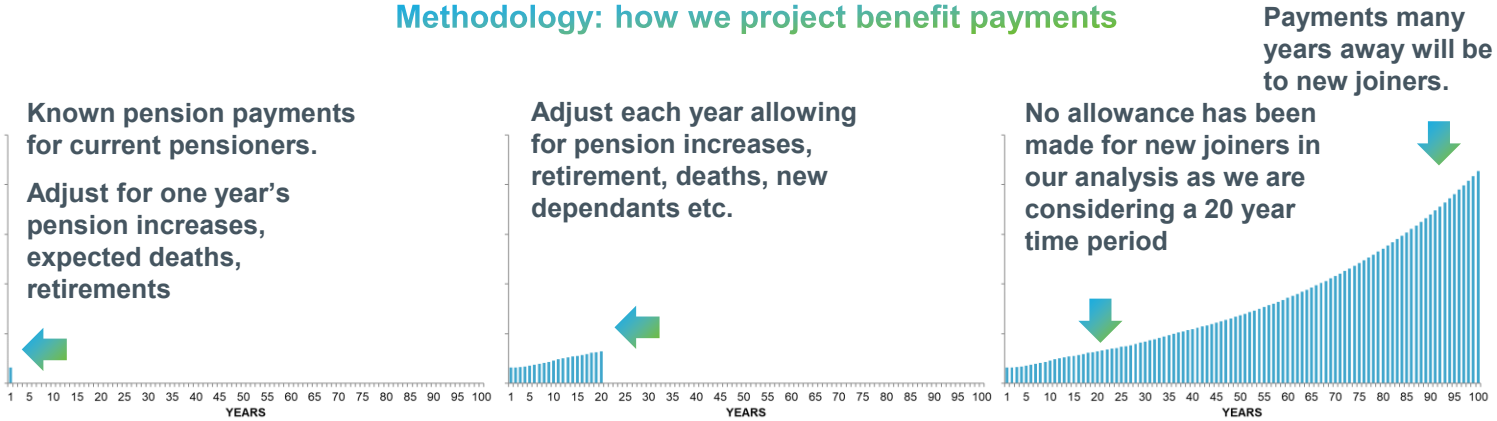
Assumptions

The demographic and financial assumptions are in line with those adopted for the 2025 valuation of the Fund unless stated otherwise.

Further information on the membership data and assumptions is detailed in the 2025 valuation initial whole Fund results report dated November 2025.

Allowance for benefit outgo in respect of benefits yet to be accrued by current active members is included in the projection; however, given the relative short timeframe considered, no allowance has been made for benefit outgo in respect of accrual by members yet to join the scheme.

Methodology: how we project benefit payments



Methodology: projecting contribution income

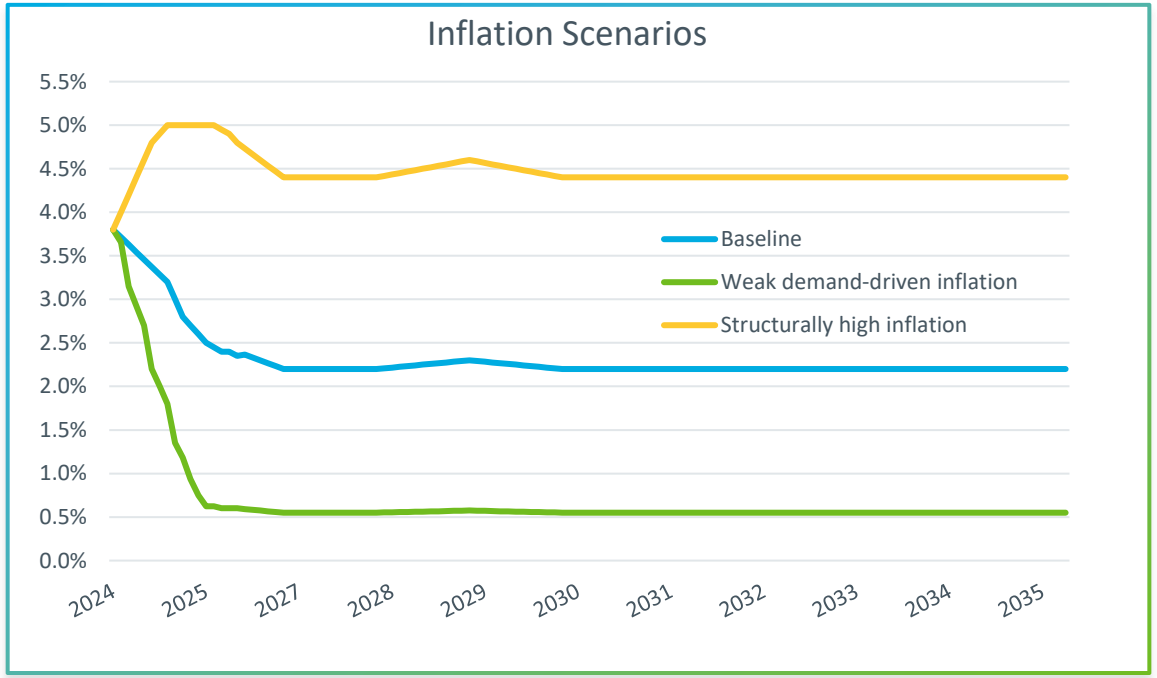
- Payroll is assumed to stay constant in real terms, i.e. it increases in line with the valuation assumption of 2.8% pa. It is uncertain how payroll may differ under varying levels of inflation, however a fixed assumption allows the sensitivity of the cashflow position to be tested against different future inflationary scenarios.
- Employer contributions are assumed to be in line with the pattern as set out on page 7
- Employee contributions are based on the weighted Fund average at the 2025 valuation (6.9% of pay).

Scenarios explored

Future CPI inflation

Given the sensitivity of future benefit payments to inflation, we have considered three potential scenarios for future inflation. All scenarios recognise an expected 3.8% increase to benefits in April 2026:

- **Scenario 1**: this **baseline** scenario represents consensus forecasts for headline CPI inflation to trend towards, albeit slightly above, the Bank of England's target over the medium-term.
- **Scenario 2**: the **weak demand-driven inflation** scenario represents deficient demand as the government embarks on fiscal consolidation. This could be achieved through tax increases and spending cuts, leading to a period of weak growth and weak demand-driven inflation (i.e. lower inflation than the baseline scenario).
- **Scenario 3**: this represents a **structurally high inflation** scenario where persistent labour shortages and subsequent wage increases, alongside supply-side disruption owing to geopolitical risks (including trade tariffs) and climate-induced disruptions lead to a period of structurally higher inflation (i.e. higher inflation than the baseline scenario).



In all scenarios we have kept the payroll assumption constant at 2.8% pa.

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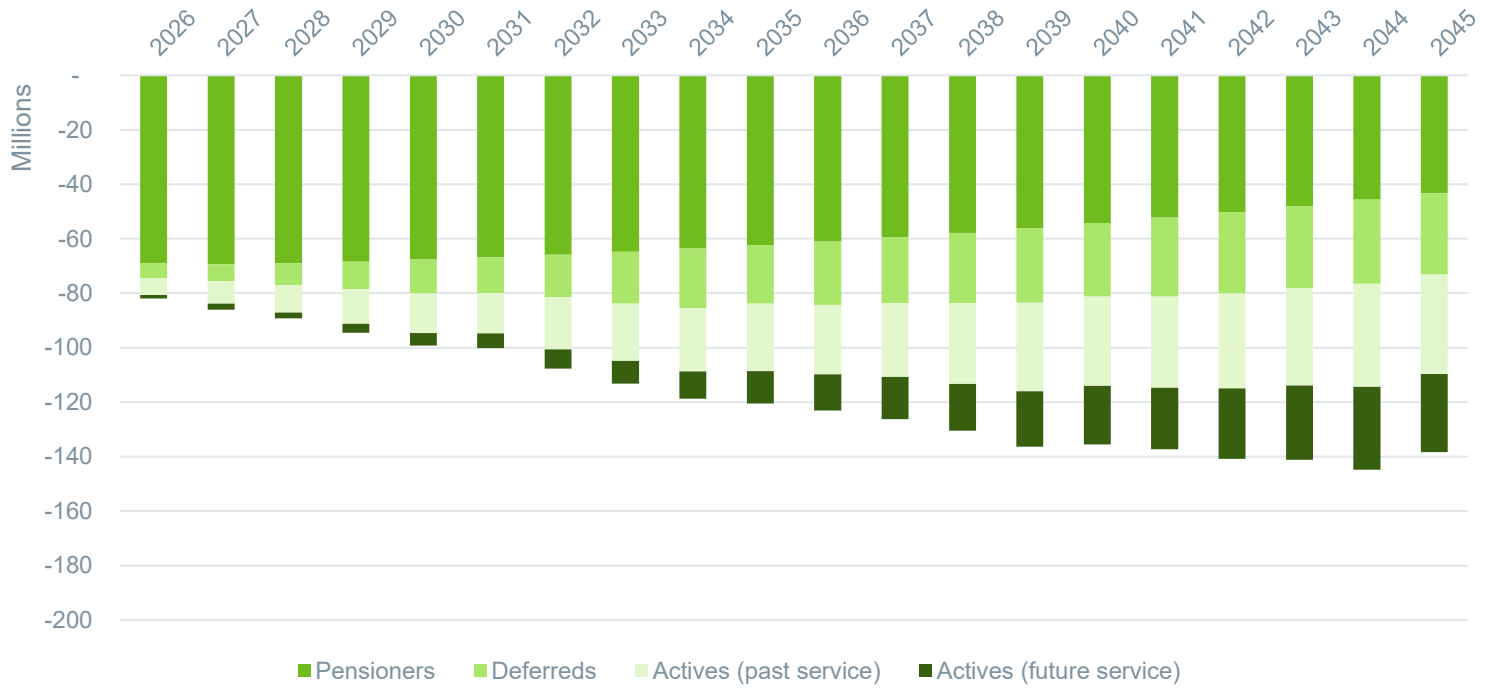
Cashflow projections

Projected benefit outflows (baseline scenario)



Notes

The years along the x-axis (horizontal) refer to the year-end i.e. 2026 means the 2025/26 financial year (from 1 April 2025 to 31 March 2026).

The Fund currently pays around £80m in benefit payments. This is expected to increase to around £140m by 2045.

Projected contribution income (all inflation scenarios)

Notes

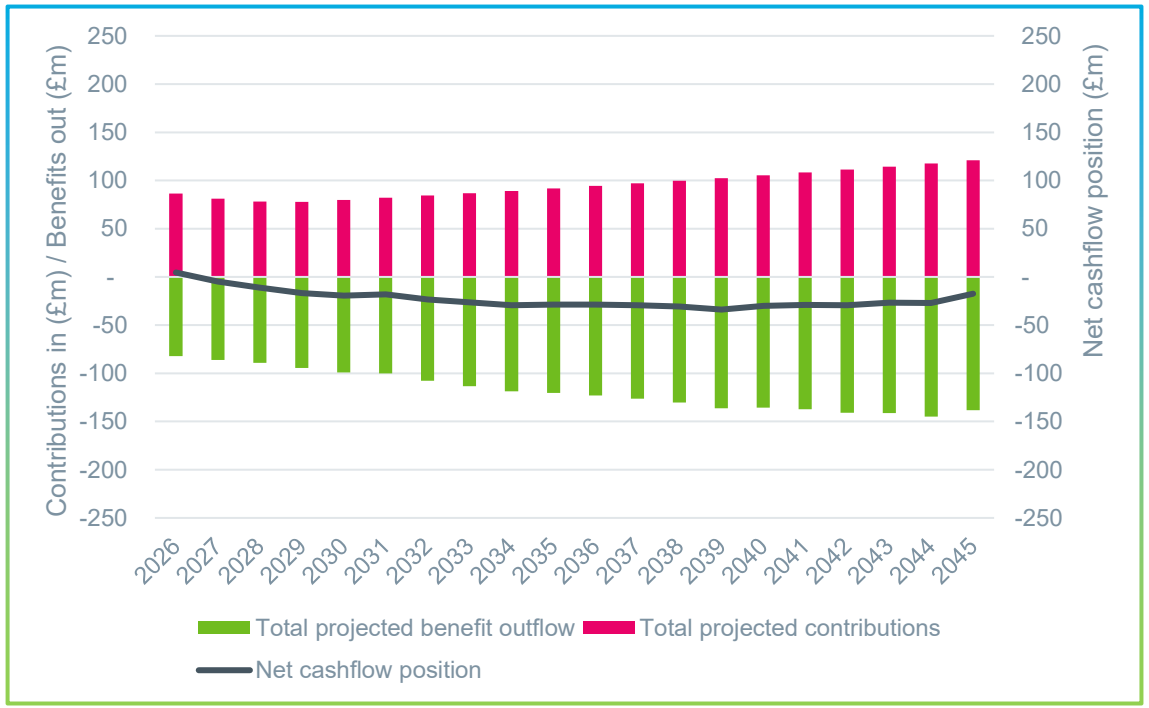
New entrants are implicitly allowed for in the income cashflow by assuming the payroll grows with inflation.

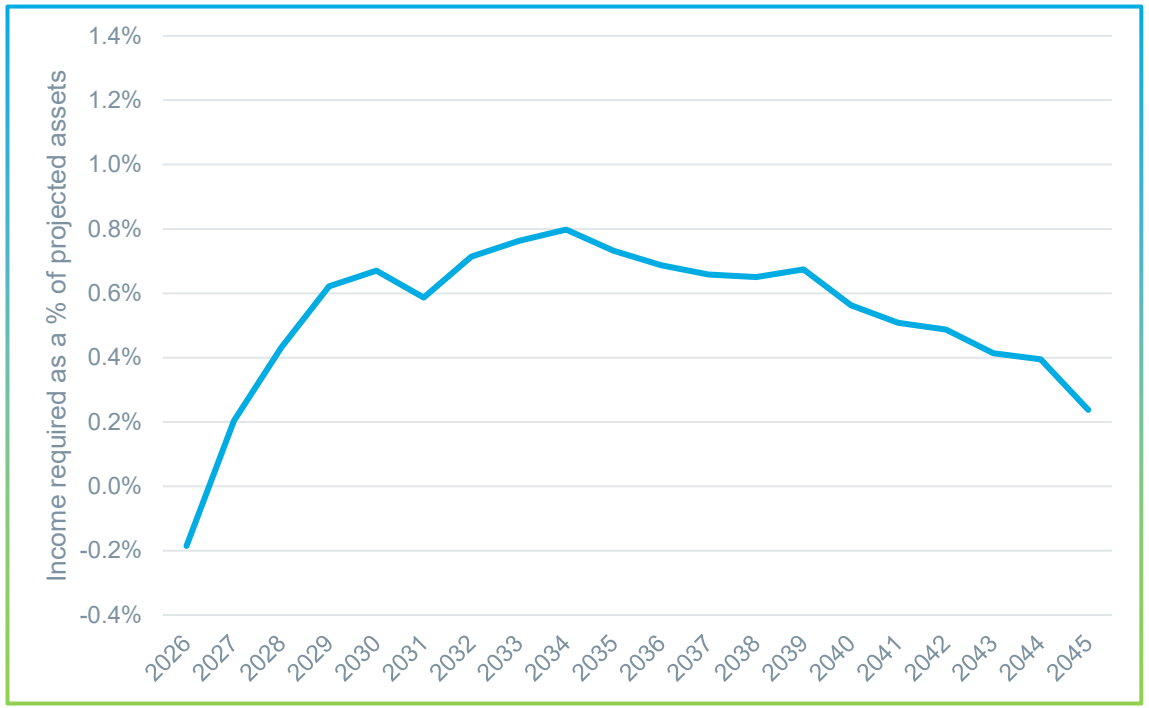
The years along the x-axis refer to the year-end i.e. 2026 means the 2025/26 financial year (from 1 April 2025 to 31 March 2026).

The drop in contribution income between 2026 and 2027 is due to the proposed reductions in contribution rates agreed as part of the 2025 valuation (e.g. an immediate reduction of 3% of pay for London Borough of Hackney, followed by further reductions of 2% and 1% of pay in subsequent years).

A significant risk to the Fund is a scenario where increases in benefit outgo exceeds growth in contribution income.

Whole fund net cashflow (baseline scenario)





Benefit outflow is estimated to exceed contribution income from 2026/27.
However, the shortfall from contributions would not require a significant level of income from assets (requiring c.0.8% yield)

Assets are assumed to increase at 6.4% pa (this is equal to the discount rate used for funding level measurement purposes at the 2025 valuation).

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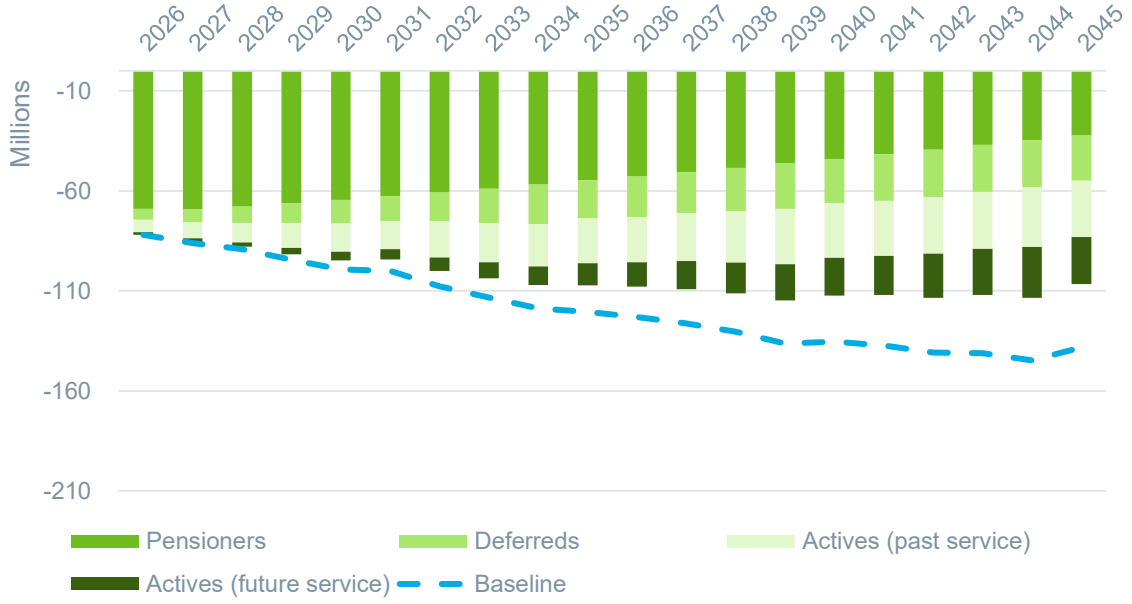
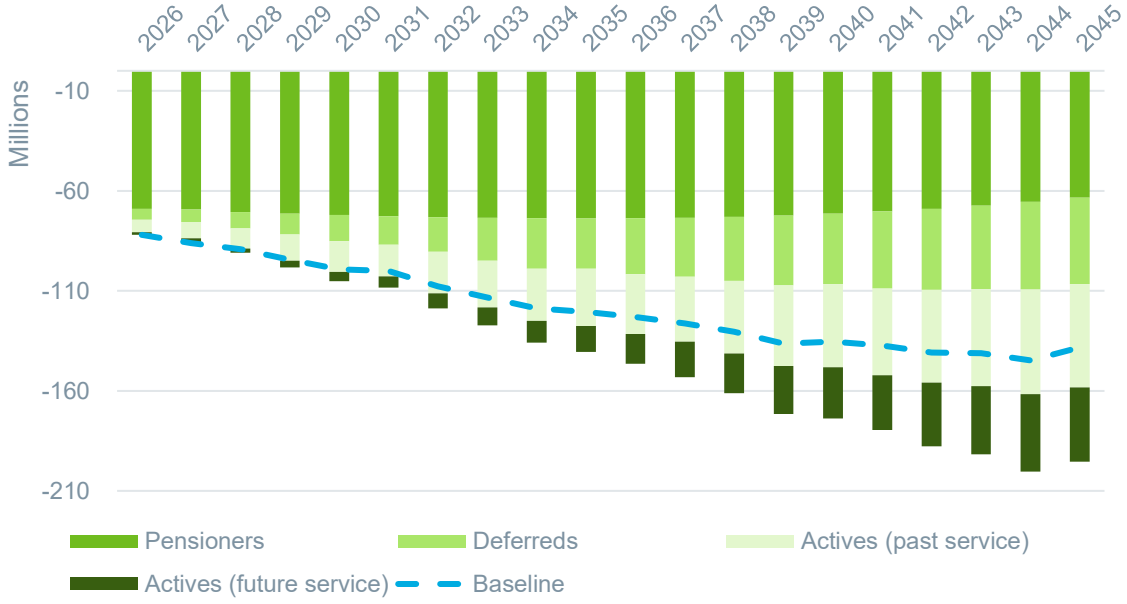
Scenario testing - inflation

Projected benefit outflows (alternative inflation scenarios)

Weak Demand-Driven Inflation

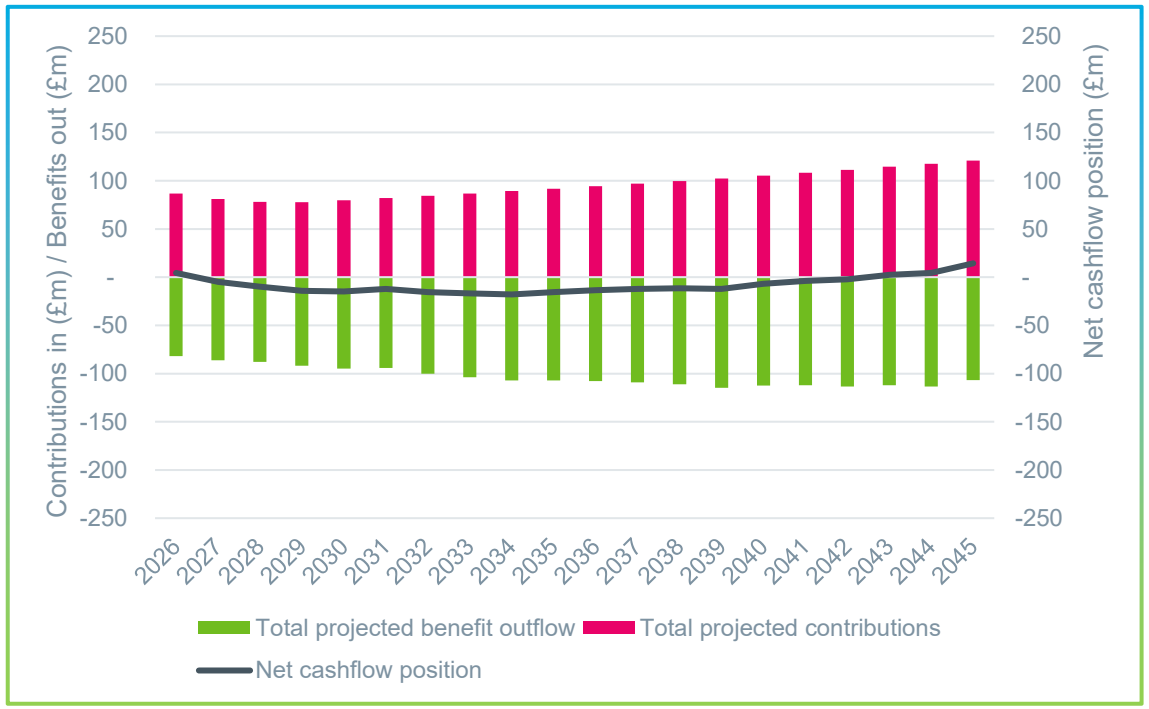


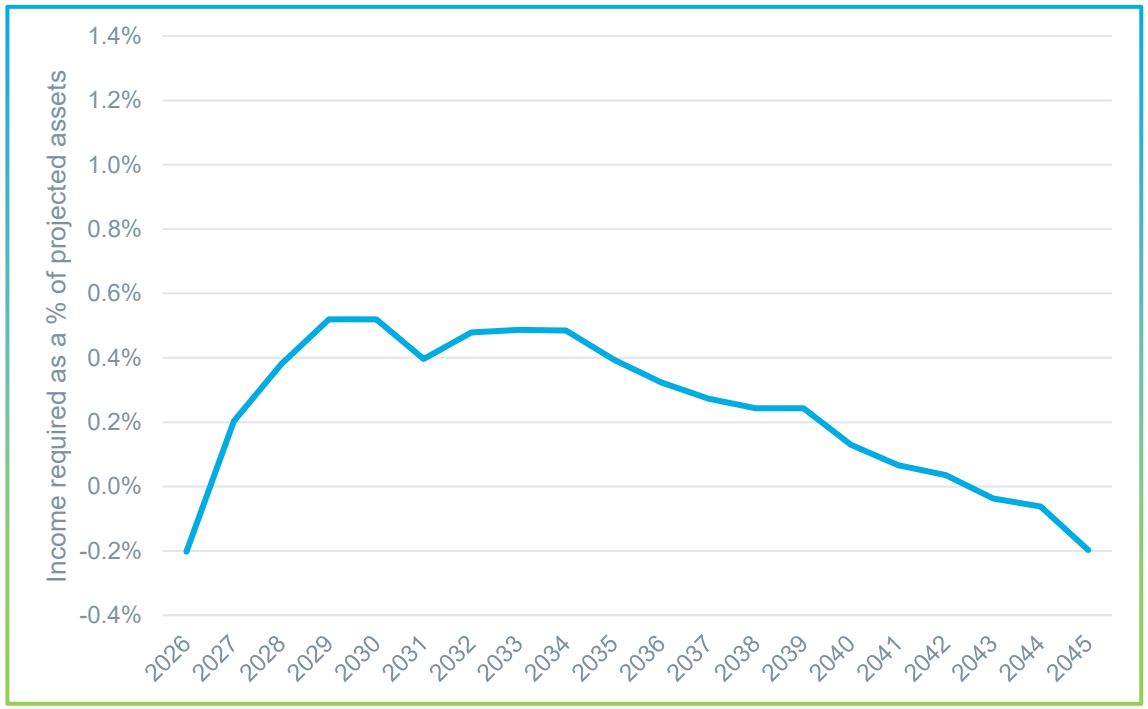
Structurally High Inflation



Scenario analysis helps understand the impact inflation may have on future benefit payments.
There is a difference of c.£90m in annual benefit payments between the above scenarios by 2045

Whole fund net cashflow (weak demand-driven inflation scenario)

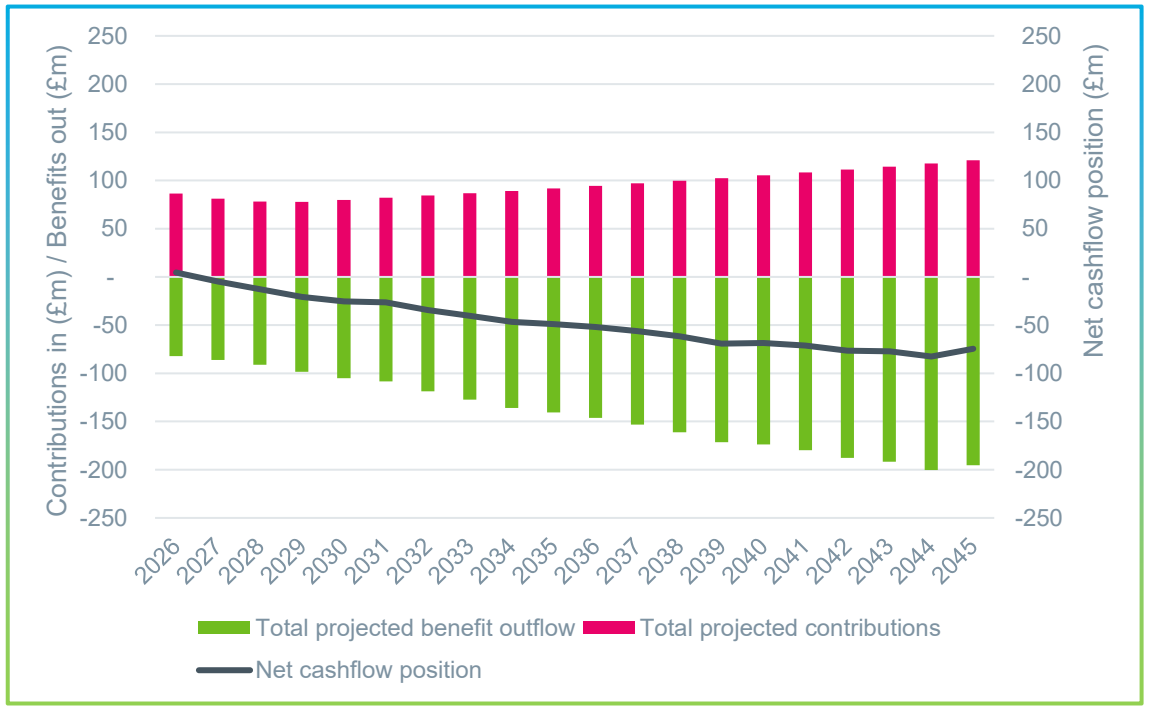


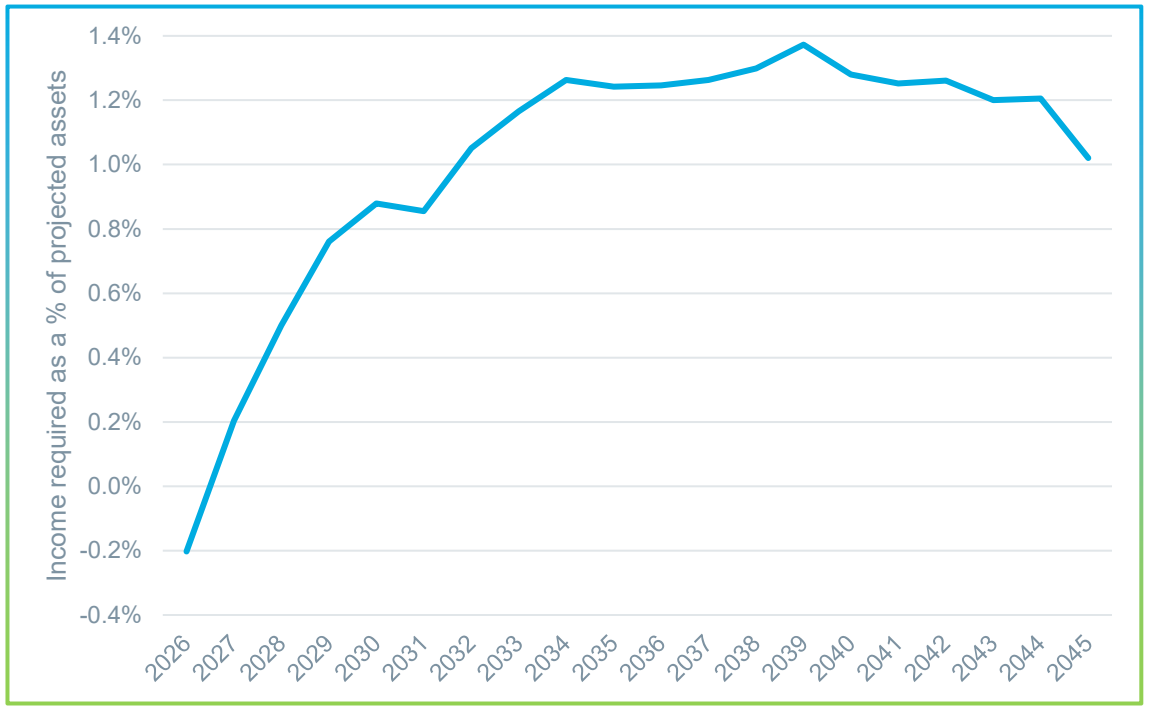


Assuming future pay increase remain at 2.8% pa, a weak-demand driven inflation scenario would improve the Fund's cashflow position in future years compared to the baseline scenario due to salary increases exceeding inflation. However, a small gap between contribution income and benefit outgo would remain and require an income yield of c0.5% pa.

Assets are assumed to increase at 6.4% pa (this is equal to the discount rate used for funding level measurement purposes at the 2025 valuation).

Whole fund net cashflow (structurally high inflation scenario)





In the long-term, the most significant risk to the Fund is a scenario where high inflation (applied to member benefits) exceeds the growth in contribution income. This scenario would worsen the Fund's cashflow position over the long-term. However, this position could be managed by income from the Fund's assets, requiring an income yield of up to c1.4% pa.

Assets are assumed to increase at 6.4% pa (this is equal to the discount rate used for funding level measurement purposes at the 2025 valuation).

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Sensitivities

Sensitivity of cashflow position

The cashflow projections set out in this report are sensitive to a number of factors. Throughout this report we have focussed on the impact of future levels of inflation, however other factors that may impact the future cashflow position of the Fund include:

- **Future salary increases** – The analysis set out in this report considers a fixed salary increase assumption of 2.8% pa. It is uncertain how future salary increases may differ in the inflationary scenarios provided. However, if salary increases were to keep pace with inflation over the longer-term, the net cashflow position would be similar to that shown under the baseline scenario.
- **Future changes in contribution rates** – Contribution rates will be reviewed at future valuations (or between valuations) and may result in an increase or decrease in contributions paid to the Fund. If contribution rates decrease at future valuations, the Fund's net cashflow position will worsen due to reduced income (or vice versa).
- **Income generation** – The Fund is currently invested in income generating assets. The cashflow projections set out in this report assume there is no investment income from the Fund's assets (i.e. all investment income is reinvested), however investment income could be used to improve the net cashflow position.
- **Transfers in/out** – Transfers in and out of the Fund can have a significant impact on the net cashflow position of the Fund. If transfers out exceed transfers in in any year, the Fund's net cashflow position will worsen (or vice versa).
- **Redundancies** – Redundancies incur immediate costs to the Fund and bring forward the payment of benefits to members. Therefore, any planned redundancy exercises may worsen the cashflow position if a significant number of member benefits come into payment earlier than anticipated (albeit the payment of early retirement strains by employers may improve the immediate cashflow position in the year these are paid).
- **Pre-payments** – Pre-payment of future contributions can significantly alter the net cashflow position of the Fund. If employers choose to pre-pay future contributions, this will improve the net cashflow position in the year of pre-payment and, as a result, worsen the net cashflow position in the following year(s).
- **Demographic assumptions** – The cashflow projections are based on the demographic assumptions set for the purpose of the 2025 valuation. These assumptions impact the timing of benefit payments (e.g. retirement age) and actual timings may differ to the assumptions made within the projections.

The Fund should closely monitor their short term cashflow requirements to ensure that benefits can be paid in any future scenario.

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Next steps

Next steps

1. Continue to monitor the impact of reductions in contribution rates and membership changes on the cashflow position
2. Consider any factors (e.g. emerging inflation) that may affect the cashflow position
3. Consider the investment strategy in light of any future possible negative cashflow position
4. If required, consider evolving or developing new cashflow management and/or rebalancing policies with your investment advisor

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Reliances and limitations

APPENDIX 1

Reliances and limitations

This paper is addressed to London Borough of Hackney as Administering Authority to the London Borough of Hackney Pension Fund. It has been prepared in our capacity as actuaries to the Fund and is solely for the purpose of projecting the expected cashflows of the Fund over a 20-year time horizon. It has not been prepared for any other purpose and should not be used for any other purpose.

The cashflow projections are based on a specific set of deterministic assumptions, which are highly unlikely to be borne out exactly. We therefore do not claim that the future will exactly match the figures in this paper. The results should be used to give an indicative idea of the Fund's medium term cashflow requirements only.

Any party must accept full responsibility for establishing that the cashflows are appropriate for the purpose to which they want to put them and any decisions that are taken based on their analysis. We cannot be held responsible for any losses sustained as a result of third parties relying on the cashflows provided, or if the cashflows are used for any inappropriate purpose

The extent of the deviations from the assumptions underpinning the cashflow projections depends on uncertain economic events as well as other factors that are not known in advance such as members' decisions, variations in mortality rates, retirement rates and withdrawal rates, fluctuations and rates of salary increase, and the numbers and ages of future new entrants which cannot be accurately predicted. In addition, there could be changes in the regulatory environment and possible changes in retirement benefits. These other uncertainties are often not related to any particular investment and economic eventualities.

Three of the important uncertainties are the:
(a) Rate of pension increases, the vast majority of which increase at the annual increase in CPI inflation
(b) Extent to which members elect to exchange pension for cash at retirement
(c) Level of future payroll and contribution rates which will determine the amount of contributions paid into the Fund

The Administering Authority is the only user of this advice. Neither we nor Hymans Robertson LLP accept any liability to any party other than the Administering Authority unless we have expressly accepted such liability in writing.

This report may be shared with the Fund's independent investment advisor for information purposes only but may not be passed onto any other third party (such as including in the public part of the Pension Committee & Board's meeting papers or the Fund's asset pool) except as required by law or regulatory obligation, without prior written consent of Hymans Robertson LLP.

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- TAS100
- TAS300.

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