



Why Surplus LGPS Funds Should Address the Housing Shortage



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UK housing offers one of the clearest routes to deploy surpluses at scale while meeting both financial and political expectations.

Consolidation and reform of the £400bn Local Government Pension Schemes (LGPS) is underway, establishing six distinct asset pools into which administering authorities must fully delegate implementation of their investment strategies. With

the 1 April 'Fit for the Future' deadline having now been and gone, we are rapidly approaching a new era of more concentrated decision-making within the LGPS.

The adoption of the LGPS (Pooling, Management and Investment of Funds) Regulations 2026 coincides with record-high surpluses among the 86 LGPS partner funds underlying the pools. The most recent estimates following the latest valuation cycle put this surplus at approximately £147bn, with the LGPS expected to grow to over £1tn in assets by 2040.

The strong position LGPS funds are in – created to a large degree by their continuing strategic allocations to risk assets such as equities in parallel with the evolving interest rate environment and corresponding movements in gilt yields – raises a fundamental question that is perhaps the first serious test pooling will face. With decision-making in transition, how do these funds decide what to do with their surpluses? And will the approaches undertaken be materially different from how the LGPS has allocated funds before?

A Double-Edged Sword

As a starting point, and perhaps counterintuitively, it is more complicated for pension schemes to manage a surplus than a deficit. In periods of deficit, the strategy is simply to most effectively plug the shortfall. But with a surplus, LGPS funds have many more considerations to take into account, including ongoing liquidity needs, governance resources, and the legal framework that LGPS funds must operate within.

Specifically, in instances of surpluses, there is pressure to reduce employer contributions, deliver contribution holidays and/or unlock funds for local investments and services. These wants must, however, be set against the fact that these are open DB schemes that are subject to long-term future actuarial return assumptions. Valuations are subject to change, meaning if they are revalued more conservatively, a prudent discount rate could adversely impact optionality in periods where employer budgets are tighter.

To ensure LGPS funds are resilient and continue to compound, it remains an imperative to grow the asset base. By definition they have strong sponsor covenants so they can afford to, and perhaps should, maintain and even increase investment risk. An opportunity delivered by the additional investment and governance resources within pooling is that schemes can build on existing surpluses and insulate against potentially more conservative return assumptions further down the line.

The Double Bottom-Line

Given the inadequacy of traditional 60-40 portfolio construction, due to its vulnerability to inflation and market volatility, and the long-term investment horizons of open DB schemes, there has been a growing acceptance that the LGPS should increase its focus on private markets to grow alpha. And, within this, include exposure to impact asset classes with local socio-economic benefits that deliver more than purely financial returns.

Given the UK housing crisis and Government's commitment to build 1.5 million homes during this parliamentary term, the compatibility of LGPS funds with investment in housing is clear. With construction faltering under the weight of cost-push inflation and the supply-demand imbalance widening, institutional capital has a financial and socio-economic opportunity to invest in the delivery of new homes.

At scale, institutionally owned and professionally managed single-family housing (SFH) offers LGPS investors inflation-matching, impact-focussed, hyper-local investment opportunities that provide both income and capital appreciation. Individually, each one of these ingredients would justify an allocation, but when combined, the investment case for the LGPS community becomes overwhelmingly compelling.

Now that the opportunity has been identified, the key remaining question is how to access it. Because SFH is so operationally geared, it is important to partner with specialist managers, those with sector expertise and demonstrable track records. Whether via separately managed accounts or pooled funds, there are multiple proven routes for the LGPS community to gain exposure.

Whichever mechanism is chosen, this period of scheme surpluses, combined with the severity of the UK housing crisis, should serve as a call to LGPS investors to take operational investment advantage of the new pooling structures and the potential increased efficiencies, governance resources and benefits of scale to leverage local capital for positive financial and local impact.



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