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| Pensions Panel | |
| 27 January 2020 | Part I |
| Treasury Management Report | |
| Report by Director of Finance and Support Services | |

Executive Summary

The Director of Finance and Support Services recommends a continuation of the current treasury management strategy in 2020/21 (*as originally approved by the Pension Panel at their January 2019 meeting*) with internally managed investments only being deposited into high creditworthy banks (that offer instant access bank account facilities) and a series of high creditworthy short-term (instant access) Money Market Funds with one amendment, reflecting the Pension Panel transition towards including more income focused asset classes within the portfolio:

- (i) An increase to the maximum limit for the amount invested per short-term Money Market Fund from £5m to £10m.

Given the strategy of maintaining a highly liquid investment portfolio held exclusively in bank unsecured deposits, the Pension Fund's internally managed cash will remain subject to bail-in risks under UK Banking Directives.

Recommendations

- (1) The Panel approves the 2020/21 Treasury Management Strategy as set out in Appendix 1.
- (2) The Panel notes the treasury activity undertaken during 2019/20 (1 April to 31 December 2019).

Treasury Management Report

Background

1. The CIPFA "Treasury Management Code of Practice" requires the West Sussex Pension Fund to determine a treasury management strategy on an annual basis regarding the investment of its internally managed cash balances. The strategy includes the "Annual Investment Strategy" (AIS) that is a requirement of the Ministry of Housing, Communities and Local Government's (MHCLG) "Investment Guidance".
2. The CIPFA Code also requires regular reports detailing compliance and performance against approved treasury strategies to be reviewed by the Pension Panel.

Economic Summary

3. The second half of 2019 has seen limited UK economic growth as Brexit uncertainty continued to take its toll; year-on-year Gross Domestic Product (GDP) was reported to be +1.1% at 30 September 2019 (+1.3% in 2018). Additionally, recent Bank of England inflation reports were notably downbeat about the outlook for both the UK and major world economies; this mirrored investor concerns around the world over expectations of a significant downturn or possibly even a recession in some major developed economies.
4. Against this economic background the Bank of England's Monetary Policy Committee (MPC) left UK Bank Rate unchanged at 0.75% throughout 2019; however following recent comments from three MPC members that the Bank of England could cut rates in 2020 to support the economy (if necessary) markets are currently forecasting the chance of a rate cut to be circa 70% by November 2020 (with a greater than 50% chance built in from March 2020). The following table gives West Sussex County Council's treasury management advisor's (Link Asset Services) central view for the path of UK Bank Rate (updated November 2019):

| Rate (%) | Mar 2020 | Jun 2020 | Sep 2020 | Dec 2020 | Mar 2021 | Jun 2021 | Sep 2021 | Dec 2021 | Mar 2022 | Jun 2022 | Sep 2022 | Dec 2022 |
|--------------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|
| UK Bank Rate | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 | 1.25 | 1.25 |

5. The interest rate forecasts provided by Link Asset Services are predicated on the basis that, whilst UK Gross Domestic Product (GDP) growth is likely to be subdued in 2019 and 2020 due to Brexit uncertainties depressing consumer and business confidence, an agreement on the detailed terms of a trade deal will likely lead to a boost to the rate of UK growth in subsequent years - which could in turn increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast and how far those increases will occur (and rise to) will be dependent on future economic data. The Link Asset Services forecasts (as presented above) therefore assume a modest recovery in the rate and timing of stronger growth in future years and in the corresponding response by the Bank in raising rates.

Treasury Management Strategy (2020/21)

6. The Director of Finance and Support Services recommends a continuation of the current treasury management strategy in 2020/21 (*as originally approved by the Pension Panel at their January 2019 meeting*) with internally managed investments only being deposited into high creditworthy banks (that offer instant access bank account facilities) and a series of high creditworthy short-term (instant access) Money Market Funds; subject to one amendment (below):
 - (i) An increase to the maximum limit for the amount invested per short-term Money Market Fund from £5m to £10m (see paragraph 7).
7. The increase in the amount invested per short term Money Market Fund reflects the availability of Funds and the high cash balances currently held by the Pension Fund, pending the implementation of its strategic allocation

decision to move towards income focused assets (infrastructure and private debt via fund arrangements, with the potential total commitment being 10% of the total Fund value). Although money for any fund investment will be drawn over time, it is appropriate for the Fund to reserve cash for this future investment to avoid additional trading cost and opportunity risk relating to any short term investment. Therefore internally managed cash balances have been high in 2019 (and are expected to remain high in 2020) whilst the decisions around future income focused investments are completed.

8. Given the strategy of maintaining a highly liquid investment portfolio held exclusively in bank unsecured deposits, the Pension Fund's internally managed cash will remain subject to bail-in risks under UK Banking Directives (which regulates that unsecured investors in a failing bank, including local authorities and local authority pension funds, would be liable in rescuing the bank instead of UK taxpayers).
9. Notwithstanding the comments in paragraph 7, the Director of Finance and Support Services will give consideration to passing surplus cash over to the Pension Fund's external fund managers (Baillie Gifford and UBS).
10. The recommended 2020/21 Treasury Management Strategy is attached at Appendix 1.

Treasury Management Performance (2019/20)

11. At 31 December 2019 the Pension Fund's internally managed cash, including balances held in EUR/USD bank accounts, amounted to £112.7m (£53.6m at 31 March 2019). During 2019/20 (to 31 December) the Pension Fund had an average internally managed investment balance, excluding foreign currency, of £105.5m (£49.4m for 2018/19; to 31 December 2018). Throughout the period investments were held in a Lloyd's interest earning current account and a series of short-term (AAA credit rated) Money Market Funds. The increase in the average internal investment amount during 2019/20 is mainly a consequence of West Sussex County Council paying over 2019/20 employer contributions as a lump sum payment at the start of April 2019 (£43.2m) and the Pension Fund's current approach not to pass surplus funds on to the external cash managers (see paragraph 7).
12. The Director of Finance and Support Services confirms that there were no breaches of the approved 2019/20 Treasury Management Strategy regarding internally managed cash during the period 1 April 2019 to 31 December 2019. The Director of Finance and Support Services further confirms that in addition to balances held for investment, foreign currency (EUR/USD) balances were held in attempting to achieve the most beneficial rates when exchanging back into Sterling.
13. At 31 December 2019 the total amount of foreign currency held was valued in GBP at £8.5m (based on 31 December exchange rates as provided by Northern Trust):

| Bank Account | Balance at 31/12/19 | Average Balance |
|----------------------------|----------------------------|------------------------|
| Lloyds - Euro Account | €3.952m | €0.597m |
| Lloyds - US Dollar Account | \$6.821m | \$1.376m |

14. In accordance with the investment strategy approved in January 2019 the Pension Fund received interest totalling £0.5m during the period 1 April 2019 to 31 December 2019 (£0.3m for 2018/19; to 31 December 2018). The rate of return achieved on GBP balances held during the period was 0.66% (0.59% during the same period in 2018/19) reflecting the low interest rates applicable on instant access GBP investments.

| Counterparty | Average Balance £'m | Interest Received £'m | Rate of Return % |
|-------------------------------|--------------------------------|----------------------------------|-----------------------------|
| Lloyds-Current Account (GBP) | 62.5 | 0.3 | 0.65 |
| Short-Term Money Market Funds | 43.0 | 0.2 | 0.68 |
| Total (i) | 105.5 | 0.5 | 0.66 |

(i) Additional interest totalling £8,317 has been received in respect of cash balances held in the Pension Fund's USD bank account.

15. During the same period West Sussex County Council achieved a rate of return of 1.30% on its invested cash balances. The higher yield reflects the Council's treasury management strategy of investing a proportion of its cash balances for periods up to 365 days and beyond (including long-term externally managed pooled investment funds) at interest rates higher than those available on the instant access accounts used by the Pension Fund.

Recommended

16. The Panel approves the 2020/21 Treasury Management Strategy as set out in Appendix 1.
17. The Panel notes the treasury activity undertaken during 2019/20 (1 April to 31 December 2019).

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Background Papers:

None