Key decision: Not applicable
Unrestricted

Pensions Committee

4 February 2022

Treasury Management Report

Report by Director of Finance and Support Services

Summary

The Director of Finance and Support Services recommends a continuation of the current treasury management strategy in 2022/23 (as originally approved by the Pensions Committee at their March 2021 meeting) with internally managed cash 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.

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 Committee approves the 2022/23 Treasury Management Strategy as set out in **Appendix A**.

(2) The Committee notes the treasury activity undertaken during 2021/22 (1 April to 31 December 2021).

Treasury Management Report

1 Background

1.1 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 Department for Levelling Up, Housing and Communities (DLUHC) "Investment Guidance".

1.2 The CIPFA Code also requires reports detailing compliance and performance against approved treasury strategies to be reviewed by the Pensions Committee.

2 Economic Summary

2.1 West Sussex County Council has appointed Link Group (Treasury Solutions) as its treasury advisor and part of their service is to assist the authority in formulating a view on interest rates. The following table gives their central view (updated December 2021):

Rate (%)	Jun 2022	Sep 2022	Dec 2022	Mar 2023	Jun 2023	Sep 2023	Dec 2023	Mar 2024	Jun 2024	Sep 2024	Dec 2024	Mar 2025
UK Bank Rate	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25

2.2 Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it back up to 0.25% at its December 2021 meeting (reversing the emergency action made at the outset of the pandemic). Going forward it is not expected that Bank Rate will go up fast after this initial rate rise as the supply potential of the UK economy is not likely to have taken a major hit during the pandemic. Therefore, the economy should be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the Bank of England's 2% target after the expected spike to over 5% in 2022.

2.3 As shown in the table above, Link Group's forecast for Bank Rate now includes four increases: one 0.25% increase in the first quarter of 2022/23, then further 0.25% increases in the fourth quarter of 2022/23, the fourth quarter of 2023/24 and the fourth quarter of 2024/25. Therefore, Bank Rate is forecast to increase from 0.25% to 1.25% over the three-year forecast period to March 2025. However, it is likely that these forecasts will need changing within a relatively short timeframe given the following significant risks to the forecasts:

- Mutations of the coronavirus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, or cannot be administered fast enough to prevent further lockdowns.
- Labour and supply shortages prove more enduring and disruptive and depress economic activity. This could lead into stagflation, or even into recession, which would then create a dilemma for the Bank of England as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.
- Rising gas and electricity prices in October 2021 (and next April) and increase in other prices caused by current supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the Bank of England's Monetary Policy Committee (MPC) having to take any action on Bank Rate to cool inflation. Therefore, risk that the MPC acts too quickly (or goes too far) over the next three years to raise Bank Rate and causes UK economic growth and increases in inflation to be weaker than currently anticipated. On the flip side however, there is the risk that the MPC tightens monetary policy too late in warding off building inflationary pressures.

- If there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out the significant remaining issues of post-Brexit UK/EU trade arrangements; for example, if the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.

2.4 In summary, with the high level of uncertainty prevailing on several different fronts, Link Group expect to have to revise their forecasts again - in line with whatever the new news is.

3 Treasury Management Strategy (2022/23)

3.1 The Director of Finance and Support Services recommends a continuation of the current treasury management strategy in 2022/23 *(as originally approved by the Pensions Committee at their March 2021 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. The recommended 2022/23 Treasury Management Strategy is attached at **Appendix A**.

3.2 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).

4 Treasury Management Performance (2021/22)

4.1 On 31 December 2021 the Pension Fund's internally managed cash, including balances held in EUR/USD bank accounts, amounted to £17.3m (£103.4m on 31 March 2021). Between 1 April 2021 and 31 December 2021 the Pension Fund had an average internally managed cash balance, excluding foreign currency, of £55.5m (£164m for 2020/21; to 31 December 2020). Throughout this period internally managed cash was held in a Lloyd's business account and a series of short-term (AAA credit rated) sterling Money Market Funds in compliance with the approved creditworthiness policy as set out in the 2021/22 Treasury Management Strategy.

4.2 As shown above, the level of internally managed cash held by the Fund has fallen in accordance with approved decisions to purchase additional investment property and income focused (externally managed) assets. As a result, the main movements (GBP) between externally/internally managed cash since 1 April 2021 are summarised below:

a) Purchases *(from internally managed cash)*: c.£493m

- Goldman Sachs and ICG Private Debt Funds (£63m)
- Investment Property-New purchases x6 (£134m)
- JP Morgan Infrastructure Fund (£250m)
- Partners Group Private Equity Fund (£46m)

These have been funded by redemptions of £352m from the Baillie Gifford Funds and internally managed cash balances.

4.3 In addition to meeting the approved creditworthiness policy (paragraph 4.1), the Director of Finance and Support Services confirms that there were no other breaches of the approved 2021/22 Treasury Management Strategy regarding internally managed cash during the period 1 April 2021 to 31 December 2021. The Director of Finance and Support Services further confirms that in addition to GBP cash balances held, foreign currency (EUR/USD) balances were held in attempting to achieve the most beneficial rates when exchanging back into Sterling.

4.4 On 31 December 2021 the total amount of foreign currency held was valued in GBP at £7.2m (based on 31 December exchange rates as provided by Northern Trust):

Bank Account	**Balance at 31/12/21**	**Average Balance**
Lloyds - Euro Account	€5.309m	€2.375m
Lloyds - US Dollar Account	$3.705m	$1.835m

4.5 In accordance with the investment strategy approved in March 2021 (internally managed cash balances) the Pension Fund received interest totalling £7,387 during the period 1 April 2021 to 31 December 2021 *(£52,581 for 2020/21; to 31 December 2020)*. The rate of return achieved on GBP balances held during the period was 0.02% *(0.04% during the same period in 2020/21)* reflecting the ultra-low interest rates applicable on instant access GBP investments.

Counterparty	**Average Balance £'m**	**Interest Received £**	**Rate of Return %**
Lloyds-Current Account (GBP)	18.2	3,538	0.02
Short-Term Money Market Funds	37.3	3,849	0.02
Total	**55.5**	**7,387**	**0.02**

4.6 During the same period West Sussex County Council achieved a rate of return of 0.60% on its invested cash balances. The higher yield reflects the County 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.

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Appendices
Appendix A – Treasury Management Strategy (2022/23)

Background Papers
None