DF/23/29
Investment and Pension Fund Committee
3 March 2023

TREASURY MANAGEMENT STRATEGY 2023-24

Report of the Director of Finance and Public Value

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

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1) Recommendation

That the Committee be asked to adopt the Treasury Management Strategy for 2023/24 as set out in Appendix 1.

2) Introduction

2.1 In December 2021, the Chartered Institute of Public Finance and Accountancy (CIPFA) published a revised Code of Practice for Treasury Management and a revised Prudential Code. As a result, the Committee adopted the revised Devon County Council Treasury Management Policy and Practices as the overarching framework for the treasury management of the Pension Fund’s cash allocation. No changes are proposed to these policies for 2023/24.

2.2 The policy requires the Investment and Pension Fund to consider a treasury strategy report for the management of the Fund’s cash allocation, setting out the strategy and plans to be followed in the coming year.

3) Treasury Management Strategy

3.1 The Treasury Management and Investment Strategy is shown in draft at Appendix 2. It sets out the current treasury position, cash investments, prospects for interest rates and the investment strategy.

3.2 The strategy is broadly consistent to that agreed for 2022/23 and is purely in relation to the management of cash, not the rest of the Fund’s investments. Pension Fund cash balances are kept at a low level with the main purpose being to provide the required level of liquidity, and do not therefore benefit from the higher rates on offer for longer term deposits. The Bank of England has raised base rates from 0.25% at the beginning of 2022 to 3.5% in December, the highest level for 14 years. This has had an impact on the rates available for investment, which have gradually increased over the period since December 2021

4) Conclusion

4.1 The Committee is asked to approve the adoption of the Treasury Management Strategy for 2023/24.

Angie Sinclair
Director of Finance and Public Value

Electoral Divisions: All

Local Government Act 1972: List of background papers

Nil

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Appendix 1

Treasury Management Strategy 2023/24

Introduction

The Treasury Management Strategy sets out the Devon County Council Pension Fund's policies in relation to the management of the Fund's cashflows, its banking, money market and capital market transactions and investment strategies.

The Pension Fund has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in December 2021. As a consequence, a revised Treasury Management Policy Statement and a statement of 'Treasury Management Practices' (TMPs) consistent with those for Devon County Council were approved by the Investment and Pension Fund Committee in February 2022 as the overarching policy framework for the management of the Pension Fund's cash allocation. No changes are proposed for these policies for 2023/24.

This Treasury Management Strategy document sets out:

- The current treasury position, debt and investments;
- Prospects for interest rates; and
- The investment strategy.

Schedule of Investments

The following schedule shows the Pension Fund's fixed and variable rate investments as at 31 March 2022 and as at 31 December 2022 (current).

Table A – Schedule of Investments

		Actual 31.03.22 £'m	Interest Rate %	Current 31.12.22 £'m	Interest Rate %
GBP Deposits					
Fixed Rates					
Term Deposits	< 365 days	0.00		10.00	4.23
	365 days & >	0.00			
Variable Rate					
Call Accounts		8.40	0.58	0.90	3.30
Money Market Funds (MMFs)		0.20	0.45	24.90	3.24
All GBP Investments		**8.60**	**0.57**	**35.80**	**3.52**
USD Deposits		**$'m**	**%**	**$'m**	**%**
Variable Rate					
Money Market Funds (MMFs)		0.20	0.25	3.80	4.37
All USD Investments		**0.20**	**0.25**	**3.80**	**4.37**

The Pension Fund's cash balance is kept at a low level sufficient to support cashflow, to ensure that pension payments are met and to fund investment commitments when required. The Fund's Investment Strategy Statement has a target 1% allocation in cash to meet these requirements. The remainder of the Pension Fund's investments are allocated to other asset classes beyond the scope of this treasury management strategy.

The recent investment performance of the Pension Fund's cash has improved as a result of rising interest rates, as the Bank of England has sought to contain inflation. The Bank of England has raised base rates from 0.25% at the beginning of 2022 to 3.5% in December, the highest level for 14 years. This has had an impact on the rates available for investment, which have gradually increased over the period since December 2021.

Prospects for Interest Rates

Forecasting future interest rate movements even one year ahead is always difficult, and the current economic environment and recent volatility in rates has exacerbated this. The factors affecting interest rate movements are clearly outside the Council's control. Whilst short term rates are influenced by the Bank of England's Base Rate, long term rates are determined by other factors, e.g. the market in Gilts. Rates from overseas banks will be influenced by their national economic circumstances. The County Council retains an external advisor, Link Asset Services, who forecast future rates several years forward. Similar information is received from a number of other sources.

Global instability and rising inflation have resulted in a significant increase in interest rates during 2022. The Bank of England has increased the Bank Rate on 8 occasions during the year taking it from 0.25% at the beginning of the year to 3.5% in December.

Market expectations are that rates will continue to increase during 2023, with the Bank of England seeking to achieve a sustainable return of inflation to target levels. The expectation is that the base rate will peak at a level of between 4.5% and 5%. The Bank of England also forecasts negative growth of -1.5% in 2023 and -1% in 2024, representing a long and deep recession. Therefore, once inflation has been brought under control the expectation is that rates will then fall to encourage growth.

The following table outlines current expectations for movements in the Bank of England's base rate.

Table B – Base Rate Forecasts

Base Rate	Dec (act) 2022	March 2023	June 2023	Sep 2023	Dec 2023	March 2024
Capita	3.50%	4.25%	4.50%	4.50%	4.50%	4.00%
Capital Economics	3.50%	4.50%	4.50%	4.50%	4.50%	4.25%

Appendix 1

Investment Strategy 2023/24 – 2025/26

The Devon Pension Fund continues to adopt a very prudent approach to counterparties to whom the Fund is willing to lend. As a result, only a small number of selected UK banks and building societies, money market funds and overseas banks in highly rated countries are being used, subject to strict criteria and the prudent management of deposits with them. The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list.

The Treasury Management Strategy will continue to be set to ensure a prudent and secure approach.

The Investment and Pension Fund Committee is required under the guidance in the CIPFA Treasury Management Code of Practice to approve an Annual Investment Strategy.

The overall aims of the Pension Fund's strategy continue to be to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims; and
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

The overriding objective will be to invest prudently, with priority being given to security and liquidity before yield.

Under the Markets in Financial Instruments (MiFID II) directive, local authorities are now classed as retail clients by the Financial Conduct Authority (FCA). This has implications for the range of investments that are available to local authorities. While bank and building society deposits are unaffected by the regulations, some banks have determined that they will only take term deposits from professional clients, and a range of alternative forms of investments are only available to professional clients. However, if the local authority meets criteria set by the FCA, then it can apply to the financial institutions with which it wishes to invest to request that the institution concerned "opts up" the local authority to elective professional client status. The Pension Fund has made applications and been opted up to elective professional client status where required.

Those counterparties who have confirmed that they will treat the Pension Fund as a professional client under the MiFID II regulations are set out in Table C below.

Table C – Counterparties that have "opted up" the Council to elective professional client status

Counterparty	Counterparty Type
Blackrock	Money Market Fund
Aberdeen Standard	Money Market Fund
Insight	Money Market Fund

In addition, brokers Tradition, Tullett Prebon and Imperial Treasury, and our treasury advisors, Link Group, have opted up the Council and Pension Fund to professional client status. The majority of bank and building society deposits are unaffected by the MiFID II regulations. This list only includes those counterparties relevant to the Pension Fund's treasury management strategy and the management of cash. The Pension Fund has also opted up to elective professional client status with the external investment managers it uses as part of its wider investment strategy.

Subject to the MiFID II regulations, a variety of investment instruments are available to the Local Authority market. In addition to the notice accounts and fixed term deposits available from UK and overseas banks, it is also possible for the Pension Fund to invest through its treasury management strategy, for example, in UK Government Gilts, bond funds and property funds. These alternative instruments would either require the Pension Fund to tie up its cash for significantly longer periods, thus reducing liquidity, or would carry a risk of loss of capital if markets go down.

The Pension Fund has considered these alternatives but, given the wider investments of the Fund and the need for liquidity with respect to the Fund's cash, has concluded that these less liquid forms of investment should not form part of the Fund's treasury management strategy.

Security is achieved by the creation of an 'Approved List of Counterparties'. These are the banks, building societies, money market funds and other public bodies with whom we are prepared to deposit funds. In preparing the list, a number of criteria will be used not only to determine who is on the list, but also to set limits as to how much money can be placed with them, and how long that money can be placed for.

Banks are expected to have a high credit rating. The Council uses the ratings issued by all three of the major credit rating agencies, Fitch, Moody's and Standard & Poor's, made available to the Council through its external Treasury Advisors. These are monitored daily.

The lowest rating published by any of the agencies is used to decide whether an institution is eligible for inclusion. Where the counterparty is only rated by two of the major ratings agencies the lowest rating published by either of the two is used. This rating also determines the maximum amount which can be loaned to an individual counterparty. Non-Eurozone overseas banks that meet the criteria are included from countries with a high Sovereign rating.

The time length of all deposits with financial institutions will be managed prudently, taking account of the latest advice from the Council's external advisors.

Money Market Funds have a portfolio comprised of short-term (less than one year) securities representing high-quality, liquid debt and monetary instruments. Many money market funds are now regarded as a more secure form of investment than bank deposits, as they diversify their investments across a range of financial institutions to spread the risk, and will therefore be used where appropriate.

Money market funds must have an 'AAA' rating to be included on the counterparty list. They may be CNAV (Constant Net Asset Value), LVNAV (Low Volatility Net Asset Value) or VNAV (Variable Net Asset Value). Yields and prices will be monitored on a daily basis to ensure that there is minimal risk of loss of capital.

Appendix 1

The Pension Fund will also make use of the US Dollar money market fund used by the Fund custodian. Cash will only be held in US Dollars where distributions are received from investments denominated in the currency and pending drawdown of commitments to US Dollar denominated funds.

Other public sector bodies are principally arms of Government, or other local authorities, and although not rated are deemed suitable counterparties because of their inherent low risk.

The 'Approved List of Counterparties' specifies individual institutions and is formally reviewed at least monthly. Notification of credit rating downgrades (or other market intelligence) is acted upon immediately, resulting in any further lending being suspended.

The following Table D summarises the current 'Approved List' criteria.

Table D – Counterparty Approved List Summary

Counterparty Type	Fitch	Moody's	Standard & Poor's	Credit Limit
UK Banks with >30% UK Government ownership				
not below	A- & F1	A3 & P-1	A- & A-1	£50 million
Other UK Banks				
not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
not below	A- & F1	A3 & P-1	A- & A-1	£30 million
UK Building Societies				
not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
not below	A- & F1	A3 & P-1	A- & A-1	£30 million
Overseas Banks				
Sovereign Rating	AAA	Aaa	AAA	
and not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
and not below	A- & F1	A3 & P-1	A- & A-1	£30 million
UK Public Bodies				
Central Government				
– Debt Management Office				Unlimited
Local Government				
– County Councils				£10 million
– London Boroughs / Metropolitan Authorities				£10 million
– English Unitaries				£10 million
– Scottish Authorities				£10 million
– English Districts / Welsh Authorities				£5 million
Fire & Police Authorities				£5 million
Money Market Funds	AAA	Aaa	AAA	£30 million

Where the short term rating of a counterparty is one notch below the stated criteria, but the counterparty meets the long term rating criteria, they may still be used subject to the advice of our external advisors (Capita) who will take into account a range of other metrics in arriving at their advice.

The credit ratings shown in the table for banks and building societies allow for greater sensitivity in recognising counterparty risk. Liquidity in investments is the second key factor in determining our strategy. Funds may be earmarked for specific purposes, and this will be a consideration in determining the period over which the investment will be made.

The counterparty limits shown in the table also apply at a banking group level. This ensures that the Pension Fund is not exposed to the risk of having maximum sums invested in multiple institutions owned by a group that encounters financial difficulties.

Borrowing Strategy 2023/24 – 2025/26

The Pension Fund will not normally need to undertake borrowing. There may, however, on an exceptional basis be a requirement for short term borrowing to aid cashflow. If short-term borrowing is required, this will be targeted at an average rate of **3.5%**.