CT/17/16
Investment and Pension Fund Committee
24 February 2017

TREASURY MANAGEMENT STRATEGY 2017/18

Report of the County Treasurer

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

Recommendations: That the Committee adopts the Treasury Management Strategy for 2017/18 as set out in Appendix 1.

1. Introduction

1.1 In February 2016 the Pension Fund, in accordance with the revised CIPFA Code of Practice for Treasury Management in the Public Services, adopted a revised Treasury Management Policy Statement together with a statement of its 'Treasury Management Practices' (TMPs). No changes are proposed to these policies for 2017/18.

1.2 The policy requires the Investment and Pension Fund to consider a treasury strategy report, setting out the strategy and plans to be followed in the coming year.

2. Treasury Management and Investment Strategy

2.1 The Treasury Management and Investment Strategy is shown in draft at Appendix 1. It sets out the current treasury position, cash investments, prospects for interest rates and the investment strategy.

2.2 The strategy is broadly consistent to that agreed for 2016/17. The target return for investments will remain at 0.40%, which is consistent with the County Council's target. In 2016/17 the Pension Fund had a lower target than the County Council, reflecting the fact that Pension Fund cash balances are kept at a low level with the main purpose being to provide the required level of liquidity, and would not therefore benefit from the higher rates on offer for longer term deposits. The reduction in rates currently available for longer term deposits has reduced the disparity.

3. Conclusion

3.1 The Committee is asked to approve the adoption of the Treasury Management Strategy for 2017/18 as set out in Appendix 1.

Mary Davis

Electoral Divisions: All
Local Government Act 1972
List of Background Papers – Nil
Contact for Enquiries: Mark Gayler
Tel No: (01392) 383621 Room G97

Appendix 1

Treasury Management Strategy 2017/18

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. This is one of the Prudential Indicators required by the Code. The current Code of Practice was published by CIPFA in November 2011, and requires the Pension Fund to approve a Treasury Management Policy Statement together with a statement of its 'Treasury Management Practices' (TMPs). A revised Policy Statement and TMPs were agreed by the Investment and Pension Fund Committee in February 2016. These policies remain appropriate and no changes are proposed for 2017/18.

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 2016 and as at 31 December 2016 (current).

Table A – Schedule of Investments

		Maturing in:	Actual 31.03.16 £'m	Interest Rate %	Current 31.12.16 £'m	Interest Rate %
Bank and Building Society Deposits						
Fixed Rates						
	Term Deposits	< 365 days	0.00		10.00	0.60
		365 days & >	0.00		0.00	
	Callable Deposits					
Variable Rate						
	Call & Notice Accounts		21.30	0.41	28.55	0.42
	Money Market Funds (MMFs)		0.00			
All Investments			**21.30**	**0.41**	**38.55**	**0.47**

The recent investment performance of the Pension Fund's cash has been affected by the low interest rates introduced as part of the measures used to alleviate the global credit crunch. Interest rates have also been impacted by the introduction of new banking regulations requiring banks to hold higher levels of liquidity to act as a buffer.

The rates on offer continue to be low and the returns on the Pension Fund's cash investments are forecast to remain at the current low levels for the foreseeable future; however, the Treasury Management Strategy will continue to ensure a prudent and secure approach.

Prospects for Interest Rates

Forecasting future interest rate movements even one year ahead is always difficult. 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, Capita, who forecast future rates several years forward. Similar information is received from a number of other sources.

Following the outcome of the EU referendum in June, the Bank of England decided to reduce UK interest rates from 0.5% to 0.25%, as a result of concerns about the impact of the decision on the UK economy. UK interest rates had already been held at an unprecedented low level of 0.5% since March 2009. Interest rates have also been under pressure across the world, with both the Eurozone and Japan seeing negative interest rates. Quantitative Easing measures to provide liquidity have been utilised widely and remain in place in the UK, the Eurozone and Japan. The introduction of new regulations requiring banks to hold a higher cash buffer has also had the effect of reducing the rates on offer. Only in the United States have interest rates begun to rise as a result of a strengthening economy.

As a result of this and other global concerns that have impacted on banks, the rates that are now available have fallen further during 2016 from the already low rates previously available in the market.

A rise in the Bank of England Base Rate is thought unlikely during 2017/18, as a result of the uncertainty arising from the decision to leave the European Union and the nature of the UK's future relationship with the EU. The following Table 11 sets out interest rate forecasts over the next year. The forecasts from Capita and Capital Economics reflect the view that the Bank of England base rate is unlikely to increase over the next financial year.

Table B – Base Rate Forecasts and PWLB Rates

	Dec (act) 2015	March 2016	June 2016	Sep 2016	Dec 2016	March 2017
Base Rate						
Capita	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
Capital Economics	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%

Investment Strategy 2017/18 – 2019/20

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 Non-Eurozone 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.

Appendix 1

The Investment and Pension Fund 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.

The outlook for cash investment remains challenging. Whereas in the past there has been a perception that Governments would not allow banks to fail, the new regulatory environment is putting more emphasis on the requirement for investors to take a hit by funding a “bail-in”. A bail-in is where the bank’s creditors, including local authorities depositing money with them, bear some of the burden by having part of the debt they are owed written off.

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 to invest, 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 Pension Fund uses the ratings issued by all three of the major credit rating agencies, Fitch, Moody’s and Standard & Poor’s, made available to the Fund 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 County Council’s external treasury management advisors.

Money Market Funds have a portfolio comprised of short-term (less than one year) securities representing high-quality, liquid debt and monetary instruments. Following the financial crisis these funds were seen as higher risk and were therefore not used by the Pension Fund. However, the new regulatory environment around the concept of "bail-in" means that 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.

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.

Table C below summarises the current 'Approved List' criteria.

Table C – Counterparty Approved List Summary

Counterparty Type		Fitch	Moody's	Standard & Poor's	Credit Limit
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
Non-Eurozone Overseas Banks					
	Sovereign Rating of	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
	– Metropolitan Authorities				£10 million
	– London Boroughs				£10 million
	– English Unitaries				£10 million
	– Scottish Authorities				£10 million
	– English Districts				£5 million
	– 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.

For the 2017/18 financial year it has been assumed that the average interest rate earned on lending to banks and building societies will be **0.40%**. This reflects the lower levels of cash maintained by the Pension Fund and the requirement for liquidity. The inclusion of overseas counterparties provides additional flexibility, but the rates offered by some banks have reduced over the last year. The target we have set for 2017/18 is thought to be one that is achievable.

Borrowing Strategy 2017/18 – 2019/20

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 **0.4%**.