Wiltshire Council

Wiltshire Pension Fund Committee

5 April 2022

Treasury Management Strategy

Purpose of the Report

1. This report seeks Members' approval for a revised Treasury Management Strategy and approval for the associated procurement process to appoint an investment manager to provide a liquidity sleeve.

Background

2. The primary purpose of the Treasury Management Strategy at Wiltshire Pension Fund is to ensure sufficient cash is available to pay liabilities when they fall due whilst minimising lost investment returns from holding assets outside of strategic investment allocations.

3. The existing Treasury process has been suitable for managing operational cash flow, payment of pensions and receipt of contributions, however the increased allocations to private market investments have changed this cashflow pattern. Private market investment capital call notices, which can be a large value, come with short notice for payment, c10 working days. This can be shorter than the time it takes to redeem cash from investment assets. Therefore, to ensure sufficient cash is available to meet the increasingly frequent capital calls the fund has been holding a higher level of cash in money market funds.

4. An increase to the holding limit, from £6m to £10m for the two money market funds and the call account was approved by Committee on 30th September 2021. This has helped to ensure cash is always available to meet capital calls in a timely manner. At the same meeting Officers committed to review the existing process and come back with a revised Treasury policy, which is presented here.

LPB Recommendation – Minute 88

5. The Local Pension Board reviewed the process for updating the Treasury Management Strategy at their meeting on 17 February 2022 and agreed to endorse the process for approval of 2020 Stewardship Code reporting, and the Treasury Management Strategy.

Main Considerations

6. The proposed new treasury management strategy splits the main components of the Fund cashflows into Regular Operational or Investment and defines an appropriate strategy for each. The strategy will ensure cash is always available to meet liabilities as they fall due, whilst minimising the 'cash drag', the foregone investment returns from holding assets outside of the strategic asset allocation for a period of time.

7. The greatest change is the introduction of a 'Liquidity Sleeve', this is an investment portfolio which provides liquidity within 1 working day whilst matching the overall

investment return of the whole portfolio. It aims to achieve this through combining a series of Exchange Traded Funds (ETF's), which provide the fund with exposure to a wide range of asset classes with short term liquidity. In researching options, this is a solution in use by another Brunel client LGPS fund to manage their own liquidity requirements.

8. The liquidity sleeve would eliminate cash drag currently experienced on cash held to meet capital calls whilst matching overall fund returns. Cash would be readily available at short notice to fund capital calls, greatly reducing the risk of having insufficient funds to meet the contractual payment date.

9. It would have the further benefit of simplifying the treasury process for operational cashflow, reducing the number of money market funds from 3 to 1 and lowering the value of funds held in such investments from a maximum of £36m to £10m. This would also deliver the benefit of reducing the volume of administrative work to approve and input transactions to move funds between these accounts to our custodian and then onto the investment funds.

10. To run a liquidity sleeve a financial institution would need to be appointed by the Fund. Given the value of investment and long term period it would be in operation, even with modest annual fees the Fund must conduct a procurement process. Officers have spoken with Brunel who do not currently offer such a solution for clients. Therefore, Officers request delegated approval to conduct a procurement exercise to identify and appoint a manager to run a liquidity sleeve to enact the Treasury Management Strategy.

11. The procurement exercise will ensure the fund attains best value with a focus on fees, quality of service, alignment with the Fund's investment strategy and ability to meet the needs of the treasury strategy. It will be supported by the Wiltshire Council procurement department.

12. Existing treasury management arrangements would remain in place until the procurement exercise is complete and a suitable manager has been appointed to run the liquidity sleeve. Regular reporting of cashflow performance will continue to be provided in the key financial controls report provided to Committee quarterly.

Fund Strategy Alignment

13. The proposed new Treasury Management Strategy achieves business plan action 11 and aligns with the following strategic vision goals.

Environmental Impact of the Proposal

14. There is no known environmental impact of this proposal.

Proposals

15. The Committee is asked to:

    a) Approval that officers through the Head of Wiltshire Pension Fund conduct a procurement exercise to appoint an investment manager to provide a Liquidity Sleeve to fulfil the Treasury Management Strategy.

    b) Approve the attached Treasury Management Strategy

    c) Approve that the attached Treasury Management Strategy should be implemented when the procurement exercise is completed.

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Head of Pension Fund

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Unpublished documents relied upon in the production of this report: NONE

APPENDIX A

WILTSHIRE PENSION FUND
TREASURY MANAGEMENT STRATEGY

1. Introduction

1.1. The primary purpose of the Treasury Management Strategy at Wiltshire Pension Fund is to ensure sufficient cash is available to pay liabilities when they fall due whilst minimising lost investment returns from holding assets outside of strategic investment allocations.

1.2. The Fund has two key categories of cashflows to consider when setting the strategy;

- **Regular Operational Cashflows *(Members payments)***
    - Monthly pension payments (paid on the 25th of each month) and twice weekly one-off payments (lump sums, transfers out etc)
    - Monthly employer and employee contributions (due by 19th of each month)
    - Running costs of the pension fund

- **Investment Cashflows**
    - Private market capital calls and capital distributions
    - Strategic asset allocation rebalancing

1.3. Over a financial year the fund has a small net inflow from the operational cashflows, with income received from contributions and transfers in marginally exceeding the cost of pensions paid, transfers out and fund running costs. Employer contributions are received by the 19th of each month increasing the cash balance ahead of the payroll being paid on the 25th of each month. Average operational cash inflow per month in 2021/22 was £11.1m and outflow was £10.4m.

1.4. The investment cashflows come from commitments to private markets portfolios with Brunel (Private Equity, Private Debt, Infrastructure), Partners Group (Infrastructure), and two new portfolios being run by the Fund (Affordable Housing and Renewable Infrastructure). These investments have an initial period where capital is called then after time these start to pay out capital distributions at the end of the fund life.

1.5. There are ad-hoc movements between investment portfolios to rebalance the investments in line with the strategic asset allocation. These are often completed through divestment and reinvestment with another manager.

2. Investment Strategy

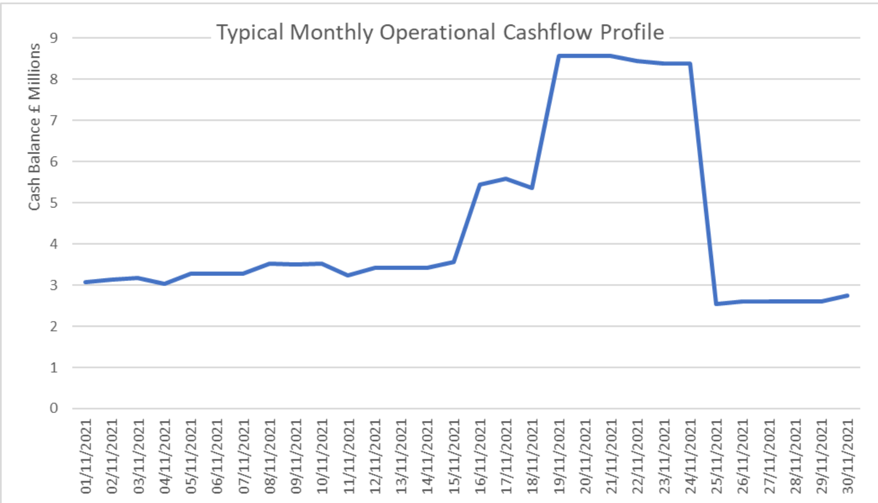
2.1. The two cashflow categories (Regular Operational and Investment) require different approaches to meet the strategy aims. The Regular Operational cashflows are more predictable, to some extent within the funds control, are forecastable and much lower in value. The Investment cashflows are irregular in timing, have a short notice period and are often very large values. To accommodate these differences each has a strategy best suited to the cashflow type.

2.2. Despite the differences there are a few overriding principles that will apply to strategies.

2.2.1. The investments must have short term liquidity, within 1 working day.
2.2.2. Suitable levels of investment return should be achieved.
2.2.3. Reputable and highly rated financial institutions will be used.
2.2.4. Investments must be in Sterling.
2.2.5. Direct investments with counterparties are not permitted (e.g. direct deals with banks or other local authorities for fixed time periods).
2.2.6. Investments must take into account wider fund objectives, e.g. Net Zero by 2050.

3. Operational Cash Flow strategy

3.1. The operational cashflow strategy is mainly driven by the receipt of employer contributions, by the 19th of each month and the payment of the pensioner payroll on 25th of each month. This results in a spike of cash of around £6m - £7m for the period of time between these two dates. As set out below in the typical monthly profile.



3.2. Outside of the spike in cash sufficient cash must be held to ensure any large payments can be met. Payment runs for these are made twice weekly and are on average £300k - £400k.

3.3. Given the short-term cyclical nature of the cash surplus on these funds this surplus cash will be managed in line with the following principles.

3.3.1. A maximum balance of £10m to be held at any point.

3.3.2. The cash balance will be maintained as low as possible throughout the month.

3.3.3. The cash balance will never become overdrawn.

3.3.4. Surplus cash will be invested in a AAA-rated Money Market Fund managed by an approved investment manager with daily liquidity.

3.3.5. A maximum of £10m to be held with a single counterparty.

3.3.6. Any cash forecast to exceed the maximum balance will be reinvested into the Funds investment portfolios.

3.3.7. Any forecast shortfall in cash will be topped up from cash withdrawn from the Funds investment portfolios.

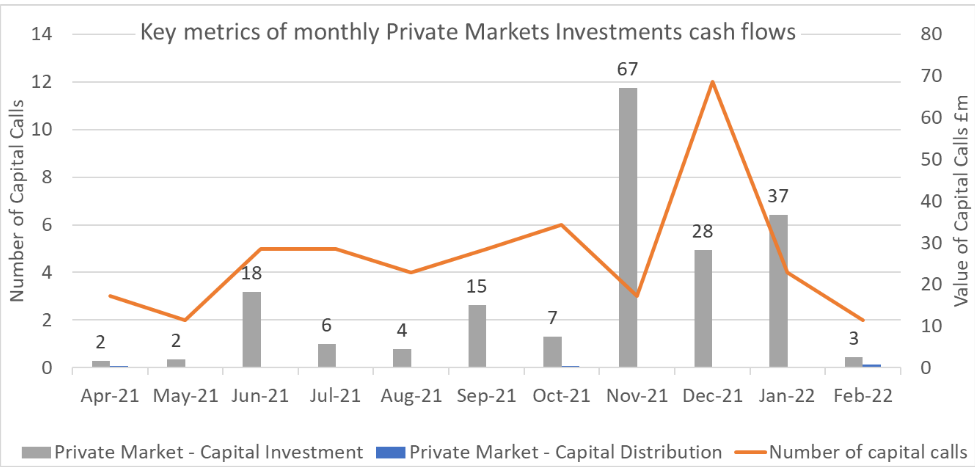
3.3.8. No investment will be made in the same funds used by the Custodian to invest any cash it holds on behalf of the Fund's investment managers.

3.4. The fund will apply these principles across two accounts used to manage operational cash, a current account for making and receiving payments, supported by a separate Money Market Fund to hold any short-term surplus cash.

3.5. Money market funds provide negligible levels of return but will ensure cash is available to pay key liabilities when they fall due. Minimising the value held within this strategy is key to lower the negative impact of lost investment returns. The very short period of time when a surplus of cash will be held also lowers this risk.

4. Investment Cashflow Strategy

4.1. The Investment Cashflow strategy is driven by the need to meet high value short notice capital calls. The following table shows recent capital calls and distribution cashflows. Average monthly capital investments have been £17.2m, with a range of between £1m and £67m. Capital calls typically have 10 working days' notice for payment to be made.



4.2. The value and volume of capital calls will increase over the next few years as the fund builds up investments in these asset classes to meet the strategic asset allocation. Once the target allocation has been reached activity will remain high as new calls will be required to offset distributions being received. Forecasting of these cashflows on an annual basis is shown below, anticipating an average monthly outflow of £14m - £17m. This will increase as allocations to affordable housing and renewable infrastructure have been made.

WPF Private Markets Calls and Distributions Forecasting					
Portfolio	**21/22**	**22/23**	**23/24**	**24/25**	**25/26**
Drawdowns					
Private equity	(31.5)	(47.3)	(59.5)	(65.5)	(61.0)
Brunel infrastructure	(16.0)	(30.0)	(44.0)	(58.0)	(64.0)
Private debt	(63.0)	(87.0)	(83.0)	(80.0)	(80.0)
Secured income (Greencoat)	(66.0)	0.0	0.0	0.0	0.0
Partners infra	(15.0)	(10.0)	(5.0)	(2.0)	0.0
Total	**(191.5)**	**(174.3)**	**(191.5)**	**(205.5)**	**(205.0)**
Distributions					
Private equity	0.9	3.5	9.6	18.4	33.0
Brunel infrastructure	0.0	0.0	2.0	4.0	9.5
Private debt	0.0	9.0	18.0	26.0	52.0
Secured income (Greencoat)	3.4	3.4	3.5	3.6	3.7
Partners infra	8.0	14.0	17.0	18.0	17.0
Total	**12.2**	**29.9**	**50.1**	**70.0**	**115.2**
Total net cashflow	**(179.3)**	**(144.3)**	**(141.4)**	**(135.5)**	**(89.8)**
Average Monthly Drawdowns	**(16.0)**	**(14.5)**	**(16.0)**	**(17.1)**	**(17.1)**

4.3. Given the high value and irregular nature of these cashflows, funds will be managed in line with the following principles;

4.3.1. An allocation of between 0% and 2% of the total Fund value will be held in a Liquidity Sleeve. (As at March 2022 - £0m to £66m)

4.3.2. The Liquidity Sleeve will utilise Exchange Traded Funds (ETF's) to broadly match the overall Fund SAA return with a low tracking error.

4.3.3. The Liquidity Sleeve will provide T+1 liquidity.

4.3.4. The Liquidity Sleeve will be provided by a reputable Investment Manager who will carry out dealing and fund balancing on the Fund's behalf.

4.3.5. The Liquidity Sleeve will be managed through the Fund's custodian with reporting on investment performance quarterly to the Committee.

4.3.6. At times it is necessary for cash to be held by the Fund's custodian, this happens when assets are moving between investment portfolios, such as when distributions are received. The Fund's custodian manages this cash in line with its own policies, making use of money market funds to provide a minimum level of return on this cash. Cash is only held in these accounts for the minimum possible duration for periods between deals.

4.4. The principles of this policy enable the fund to minimise the impact of ‘cash drag’ This is when the fund holds large values of cash which earn a lower or different rate to the overall strategic asset allocation, lowering overall return. A Liquidity Sleeve should ensure the investment return on any assets held here broadly match the overall return of the Funds investment portfolio, eliminating the impact of cash drag.

4.5. A liquidity sleeve will provide an efficient and reliable administrative process to ensure funds are available to meet capital calls and other liabilities, significantly reducing the risk any of these cannot be met which would have significant contractual implications for the Fund.

5. Borrowing Policy

5.1. The Fund is not permitted to borrow under the regulations, except by way of a short-term loan or overdraft from a bank (repayable within 90 days), and then only in exceptional circumstances where funds are required for:

- Paying benefits due under the Scheme; or
- Meeting investment commitments arising from the implementation of a decision by the Committee to change the balance between the different types of investment.

6. Operational Implementation and Reporting

6.1. Management of the Operational Cashflow strategy will be carried out by the Wiltshire Council Treasury management team under a Service Level Agreement. All assets are invested separately from the Council’s and all monies will be paid out of and received back into the Pension Fund bank account.

6.2. Management of the Investment Cashflow strategy will be carried out by Pension Fund Officers ensuring the allocation remains within the permitted range. They will oversee the Investment manager implementing the Liquidity Sleeve, receiving regular reporting and meeting to review performance against target.

6.3. Reporting of performance against this strategy will be provided quarterly to the committee via the Key Financial Controls Report and Investment Quarterly Update.

7. Regulatory Context

7.1. In setting this strategy the Fund has taken regard of the following relevant regulations and legislation.

7.1.1. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 which came into force 1 November 2016.

7.1.2. The Ministry of Housing Communities and Local Government's (MHCLG's) Guidance on Local Government Investments ("the Guidance") issued under section 15(1)(a) of the Local Government Act 2003 and effective for financial years commencing on or after 1 April 2018 and any revisions to that Guidance

7.1.3. The 2017 revised CIPFA Treasury Management in Public Services Code of Practice ("the CIPFA TM Code"); and Cross Sectoral Guidance Notes;

7.1.4. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 and any revisions to these regulations.