HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Pension Fund Panel and Board
Date:	28 July 2023
Title:	Investments: Pension Fund Cash – Annual Report 2022/23
Report From:	*Director of Corporate Operations*

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Purpose of this Report

1. The purpose of this report is to update the Pension Fund Panel and Board on the policy for managing the Hampshire Pension Fund's cash balance.

Recommendation

2. That the outturn report on the Pension Fund's cash management in 2022/23 be approved.

Executive Summary

3. This report provides an annual review of the policy for managing the Hampshire Pension Fund's cash balance. The Pension Fund adopts the key recommendations of the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services: Code of Practice, which includes producing an annual report on the treasury management strategy after the end of each financial year.

Background

4. The Pension Fund receives cash each month from contributions made by employees and employers, and from investment income. The Pension Fund requires a cash balance to be able to pay pensions and other costs. Cash is also required for the following investment reasons:
   - if the UK property manager CBRE Investment Management purchases additional properties;
   - to finance drawdowns of private equity and private debt limited partnerships and co-investments; and

- to finance drawdowns of infrastructure investments.

5. Dividends from shares and interest receipts from bonds are retained by the external investment managers for reinvestment in the pooled vehicles that they manage, but rental income from the Pension Fund's direct property portfolio is credited to the Fund's cash balance. Distributions from the Fund's private equity, private debt and infrastructure investments are also paid out into the Fund's cash balance.

6. The Pension Fund's investment managers aim to be fully invested, and generally do not plan to hold cash as a matter of investment policy. All of the Fund's investment managers will have some cash balances as a result of trading between stocks and from dividend and interest income pending investment, and these balances are held within the pooled funds that they manage.

7. There are rigorous procedures in place to ensure the security of all cash deposits which are managed by the County Council in separate investment accounts for the Pension Fund. These include criteria for the quality of counterparties and limits on the amount that can be placed with any one counterparty as set out each year in the Pension Fund's Annual Investment Strategy for cash. The latest strategy for 2023/24, was approved for immediate implementation by the Pension Fund Panel and Board on 16 December 2022. In addition, the County Council's treasury advisers, Arlingclose, provide advice to the Director of Corporate Operations in undertaking treasury management activities.

Investment activity

8. Security of capital remains the Fund's main investment objective for the management of the cash balance. This was maintained during 2022/23 by following the Fund's counterparty policy as set out in its Annual Investment Strategy, which was approved by the Pension Fund Panel and Board on 10 December 2021 and updated on 16 December 2022. Investments during the year included:
   - Investments in AAA-rated Money Market Funds
   - Investments in UK Government Treasury Bills
   - Call accounts, notice accounts and certificates of deposit with banks and building societies with a minimum credit rating of A-, or equivalent

9. In addition to credit ratings counterparty credit quality was assessed and monitored with reference to:
   - credit default swap prices
   - any potential support mechanisms
   - share prices

- other economic or financial data.

10. Based on these factors and advice from the Treasury Management advisers, Arlingclose, the Director of Corporate Operations on behalf of the Pension Fund has varied investment duration limits for new investments according to the assessment of credit risk and has suspended investing with individual counterparties when it is felt to be necessary to protect the Pension Fund's capital. The placement of actual investments is likely to be below these limits and will depend on both the Fund's requirements, such as the need to maintain a high degree of liquidity, and the availability of counterparties in the market.

11. As detailed in paragraph 4, the Pension Fund holds invested cash, representing income received in advance of expenditure plus investment income. The year-end cash position and the year-on year change are shown in Table 1.

Table 1 – Cash investment position	**31/03/22 Balance**	**Net movement**	**31/03/23 Balance**	**31/03/22 Income return**
	£m	**£m**	**£m**	**%**
Banks and building societies:				
- Unsecured	17.31	(12.42)	4.89	3.47
Money market funds	56.64	(21.32)	35.32	4.07
Total	**73.95**	**(33.74)**	**40.21**	**3.99**

12. As at 31 March 2023 the Pension Fund's cash balance was £40.2m compared to £74.0m as at 31 March 2022 and during the year, the Pension Fund's cash balances ranged between £40.2m and £116.8m due to timing differences between income and expenditure. The balance was particularly low on 31 March 2023 in anticipation of the receipt of £321m of employer's pension contributions that were received on 1 April 2023.

13. The Fund's average cash investment balance was £72.9m during 2022/23 (0.81% of the total Pension Fund investments based on the average value during the financial year), and interest earned was £1.6m, leading to an average yield of 2.2%.

14. In delivering cash investment returns, the Fund has operated against a backdrop in which the Bank Rate has increased from 0.75% at the beginning of the year to 4.25% at the end of March 2023. Short-dated cash rates, which had ranged

between 0.7% - 1.5% at the beginning of April 2022, rose by around 3.5% for overnight/7-day maturities and 3.3% for 6-12 month maturities.

Pension Fund cashflow

15. The Pension Fund monitors its surplus or deficit from dealings with members; the extent to which income from employer and employee contributions are greater or less than the outgoings on pensions and other costs. It has been reported that a number of LGPS funds are experiencing annual cash deficits from their dealings with members, which will result in them having to liquidate some of their investments to continue to meet their obligations for payments to scheme members.

16. In recent years the Fund has generated a surplus from dealing with members. However, for 2022/23 the Fund had a deficit of £82.9m, compared to a deficit of £88.8m in 2021/22. This was due to the impact of employers choosing to pay three years' worth of pension contributions in advance on 1 April 2020. Despite the uneven impact of employers making 3-year prepayments, the Pension Fund now has a clearer picture of its net position from dealing with members at the end of 2022/23, the end of the three-year triennial valuation period which shows net additions of £53.9m. This position is shown below in Table 2 with the previous three year triennial period shown for comparison.

Table 2 – Dealings with members, employers and others directly involved in the Fund	**2020/21**	**2021/22**	**2022/23**	**Three year period (Total)**	**2017/18 to 2019/20**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Contributions	497,238	199,267	222,220	918,726	929,022
Transfers in from other pension funds	13,748	16,178	22,195	52,121	56,109
	510,986	**215,445**	**244,415**	**970,846**	**985,131**
Benefits	(270,665)	(285,525)	(305,223)	(861,414)	(755,722)
Payments to and on account of leavers	(14,630)	(18,758)	(22,154)	(55,542)	(62,271)
	(285,295)	**(304,283)**	**(327,378)**	**(916,956)**	**(818,042)**
Net additions from dealings with members	**225,691**	**(88,838)**	**(82,963)**	**53,890**	**167,089**

17. The figures in Table 2 show that for the latest triennial period to 2022/23 the Pension Fund has maintained a cash surplus from its dealings with members, although this has reduced in comparison to the previous three-year period. As reported to the Panel and Board in March 2023 as part of the consideration of the revised investment strategy, the Fund is forecast to move into a cashflow deficit in the new triennial period as the inflationary increase to benefits paid outstrips contributions. The forecast shortfall from dealing with members is £28m p.a. The revised investment strategy agreed in March 2023 included changes to take income from more of the Fund's portfolios to help mitigate this shortfall.

Climate Change Impact Assessments

18. Hampshire County Council utilises two decision-making tools to assess the carbon emissions and resilience of its projects and decisions. These tools provide a clear, robust, and transparent way of assessing how projects, policies and initiatives contribute towards the County Council's climate change targets of being carbon neutral and resilient to the impacts of a 2℃ temperature rise by 2050. This process ensures that climate change considerations are built into everything the Authority does.

19. The Pension Fund itself has a negligible carbon footprint, but it recognises that the companies and other organisations that it invests in will have their own carbon footprint and a significant role to play in the transition to a lower carbon economy. Therefore, the Pension Fund recognises the risk that environmental, social and governance (ESG) factors including the impact of climate change can materially reduce long-term returns. The Pension Fund has a role to play as an investor, in ensuring that its investment managers are suitably considering the impact and contribution to climate change in their investment decisions and acting as a good steward to encourage these companies to play their part in reducing climate change. This is explained further in the Pension Fund's RI policy: Investment Strategy Statement | Hampshire County Council (hants.gov.uk).

20. This report deals with the outturn position for the Pension Fund's internally managed cash portfolio. In line with the CIPFA code, the Pension Fund's cash balances are invested prioritising security, liquidity and then yield. The cash portfolio is only required to pay pensions, other costs and new investments. There are no further climate change impacts as part of this report which are concerned with financial reporting.

REQUIRED CORPORATE OR LEGAL INFORMATION:

Links to the Strategic Plan

Hampshire maintains strong and sustainable economic growth and prosperity:	no
People in Hampshire live safe, healthy and independent lives:	no
People in Hampshire enjoy a rich and diverse environment:	no
People in Hampshire enjoy being part of strong, inclusive communities:	no
OR	
This proposal does not link to the Strategic Plan but, nevertheless, requires a decision because of the ongoing management of the Hampshire Pension Fund.	

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

<u>Document</u>	<u>Location</u>
None	

EQUALITIES IMPACT ASSESSMENTS:

1. Equality Duty

The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited by or under the Act with regard to the protected characteristics as set out in section 4 of the Act (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation);
- Advance equality of opportunity between persons who share a relevant protected characteristic within section 149(7) of the Act (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic within section 149(7) of the Act (see above) and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- The need to remove or minimise disadvantages suffered by persons sharing a relevant protected characteristic that are connected to that characteristic;
- Take steps to meet the needs of persons sharing a relevant protected characteristic that are different from the needs of persons who do not share it;
- Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionally low.

2. Equalities Impact Assessment:

Equality objectives are not considered to be adversely affected by the proposals in this report as the proposals do not directly affect scheme members.