Cash Management Policy

The purpose of this document is to present a suitable cash management policy, setting out rules relating to the balance of cash held by the Fund based on short-term cashflow forecasts.

Policy

Based on current cashflow requirements and investment strategy, the following policy is to be adopted:

- A target working cash balance of at least £5m. This amount should be permitted to vary between £3m and £6m.
- This cash balance is sufficient to cover one month of predictable benefit outgoings plus three months unpredictable outgoings.
- The cash balance will be replenished by monthly contributions (which are broadly equal to predictable monthly outgoings) and by income drawn from the UK property portfolio.
- The working cash balance should be reviewed on a monthly basis immediately following receipt of contributions, and:
- In the event that cash levels fall below the lower limit, assets will be disinvested from the most overweight allocation within the investment strategy so as to increase the working cash balance to £5 million.
- In the event that cash levels rise above the upper limit:,
    - cash will be invested in the most underweight allocation within the investment strategy so as to reduce the working cash balance to £5 million, or
    - to be retained above the upper limit at the discretion of the Deputy Chief Executive Communities and Resources to meet unforeseeable volatile unpredictable payments.
- This policy should be reviewed in the event of an increase in monthly cash outflow of 5% from current levels.

Introduction

Cashflow management is an integral element of the administration of any pension scheme. The Fund has to meet its ongoing benefit payments. These may be predictable payments, such as the monthly pension payroll, or more unpredictable payments such as transfer value payments, retirement lump sums or death benefits.

In order to be able to meet these benefit payments, the Fund therefore requires ready access to cash. Cash may be obtained from payments into the Fund in the form of contributions, from income drawn from the Fund’s assets or by the sale of assets.

In developing a cashflow management policy, it is desirable that:

- The cash balance maintained is not so large as to reduce the potential for future investment returns.
- The cash balance maintained is not so small so as to create a risk that the balance will be easily exhausted, and thus disinvestments will be required either frequently or at short notice.
- Assets are realised in the most efficient manner possible.

Analysis of Historical Cash Flow

The initial analysis of the cash flow in and out of the fund was undertaken by Hymans for the period 1 April 2011 to 31 March 2012. This focussed on establishing the predictable level of monthly income and outgoings and considered the range of unpredictable outgoings.

Further analysis of the cash flow movements follows on from that initial analysis and covers the period 1 April 2012 to 31 March 2015.

Predictable Cashflow

The Fund needs to maintain a cash balance in order to meet predictable outgo.

- Predictable income includes employer and employee contributions
- Predictable outgoings include benefit payments.

Table 1 below shows the predictable income and outgoings (in £m) over the period 1 April 2012 to 31 March 2015.

Table 1	**2012/13**	**2013/14***	**2014/15**	**Total over 3 years**	**Average per month**
	£m	**£m**	**£m**	**£m**	**£m**
Income	28.7	30.2	31.2	90.1	2.5
Outgoing	26.1	27.6	29.4	83.1	2.3
Net	**2.6**	**2.6**	**1.8**	**7.0**	**0.2**

**Excludes £11.5m additional contributions as came in and out in the same month.*

From Table 1 it can be seen that on a predictable basis the Fund is slightly positive. Average income over the three year period was £2.5m per month giving an average net income of £0.2m per month.

Note that a relatively small change in membership of the pension scheme (i.e. a shift from active to pensioner) or the continual passage of time may result in net predictable income being consistently negative in future.

Unpredictable Cashflow

The Fund also needs to maintain a cash balance in order to meet unpredictable payments.

– Unpredictable income includes transfers in from other pensions and strain costs.
– Unpredictable outgoings include transfers out to other funds, retirement allowances, death benefits and ill health allowances.

Table 2 below shows the unpredictable income and outgoings (in £m) over the period 1 April 2012 to 31 March 2015.

Table 2	**2012/13**	**2013/14**	**2014/15**	**Total over 3 years**	**Average per month**
	£m	**£m**	**£m**	**£m**	**£m**
Income	3.9	3.3	2.0	9.2	0.3
Outgoing	8.8	7.4	7.5	23.7	0.7
Net	**(4.9)**	**(4.1)**	**(5.5)**	**(14.5)**	**(0.4)**

From Table 2 it can be seen that unpredictable net cashflow is very volatile and on average is cash flow negative. The average net monthly outgoings were (£0.4m). Monthly net outgoings range between (£0.1m) and (£1.1m)

Recognising that, once unpredictable outflow is taken into account, the Fund is cash flow negative (£0.2m).

Unpredictable cashflow including drawdown & cash injections

Consideration can also be given to drawing the income generated by the Fund's assets, this being more cost effective than realising assets.

Based on current allocations to each mandate the Fund can draw down the following income, each quarter, from both Royal London Asset Management and UBS:

- Royal London UK Bond Portfolio - £850,000
- UBS Triton Property Fund - £300,000 (already drawn down)

The Fund can thus realise an additional £1.2m in cash each quarter.

Income from the other investments is reinvested with the respective portfolios as part of the mandate arrangements. Currently income from the property units is already drawn down, rather than being reinvested. The rental income currently drawn down is included within the drawdown column in Table 3 that follows in this report.

Arrangements are in place to retain income from the bond portfolio if required although this has not yet been necessary and the least desirable option as this may have an impact on the performance target for RLAM and realising income will ultimately create an imbalance in the overall asset allocation which will need to be managed and in the event of any breach of agreed tolerance margins, the Fund would need to be rebalanced

In addition to drawing cash from the property mandate cash injections are made by Havering Council to protect the fund from decreasing payrolls.

Table 3 shows the effect of including the drawdown of rental income and cash injections made by the London Borough of Havering over the period 1 April 2012 to 31 March 2015.

Table 3	**2012/13**	**2013/14**	**2014/15**	**Total over 3 years**	**Average per month**	**Drawdown & Cash injection over 3 years**	**Average per month**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	
Income	3.9	3.3	2.0	9.2	0.3	14.3	0.4
Outgoing	8.8	7.4	7.5	23.7	0.7	0	0
Net	**(4.9)**	**(4.1)**	**(5.5)**	**(14.5)**	**(0.4)**	**14.3**	**0.4**

From Table 3 it can be seen that the drawdown of rental income and cash injections offsets the negative unpredictable cash position.

Overall the cash position is marginally positive.

Working Cash Balance

In establishing an acceptable working cash balance, we wish to determine a sum that is sufficient to cover predictable benefit payments, taking account of expected cashflow, whilst also providing a buffer to meet unpredictable payments together with any deterioration in cash inflow.

It is proposed that the working cash balance (immediately after receipt of monthly contributions) is set as £5 million, being the sum of:

- £2.3m, the approximate current average predictable monthly outgoings, and
- £2.7m, roughly three times the average monthly unpredictable monthly outgo (£0.4m x 3 = £1.2m) and 1.5 times the highest monthly unpredictable outgo (£1.1m x 1.5= £1.6) over the previous twelve month period.

Targeting a cash balance of £5m should provide the Fund with sufficient leeway to meet all payments due on a monthly basis without facing a forced requirement to disinvest. Cash at this level represents approximately 1% of total Fund assets.

Trigger Levels

Obviously, cash levels will vary as benefits are paid and it is therefore appropriate to review the Fund's cash balance periodically in order that the level of cash held can be adjusted.

The cash balance is reviewed on a monthly basis immediately after receipt of monthly contributions and that the following triggers are used as a basis for action:

- In the event that the cash balance at the start of the month is less than £2.5m, then the cash balance should be topped up to the £5million by way of disinvestment. This level recognises that some discretion may be exercised over the timing of the unpredictable payments.

- In the event that the cash balance at the start of the month is continually greater than £6m, then cash may be invested to reduce the cash balance to £5m.

- In the event that the monthly pension payroll increases or decreases by more than 5% above current levels (i.e. above £2.6m), then this policy should be reviewed.

Disinvestment Arrangements

In agreeing the disinvestments, we should also take account of the underlying liquidity of each of the Fund's investments together (and therefore how readily available cash actually is) alongside the administrative complexity of instructing frequent disinvestments.

Given the illiquidity of the Property mandate, we propose that this be excluded as a potential source of cash (except for rental income). Further, we propose the Ruffer Absolute Return mandate being a dynamic mandate and therefore having the objective of stabilising overall investment returns also be excluded as a potential source of cash.

The choice of mandate for disinvestment purposes should be based on the current asset allocation relative to the target allocation, with the disinvestment made from the most overweight allocation.

In the event that cash is available for investment, that cash should be invested in mandate which is most underweight relative to its target allocation. For the purposes of investment, all mandates should be included.

Review of policy

In the event that monthly benefit outgoings increase by more than 5% above current levels (£130k per month), the cash policy be reviewed.