From:	**John Simmonds, Deputy Leader & Cabinet Member for Finance & Procurement;** **Andy Wood, Corporate Director of Finance & Procurement**
To:	**Cabinet – 16 September 2013**
Subject:	**Treasury Strategy Update**
Classification:	**Unrestricted**

Summary:	To propose changes to the Council's treasury strategy by expanding the range of types of investment which can be made.
Recommendation(s):	Cabinet is asked to agree the proposed changes set out in paragraph 15 of the report.

Introduction

1. In February 2013 Council agreed the Annual Treasury Strategy as part of the Council's budget. The treasury strategy covers the borrowing and investment policies which will be followed in managing the Council's cashflow and reserves.

2. Treasury management activities need to comply with CLG Guidelines and the mandatory CIPFA Code of Practice on Treasury Management.

3. Within the Council the Treasury Advisory Group, an all party sub-group of Cabinet, meets 3-4 times a year to look at Treasury issues in detail and Governance & Audit Committee receives quarterly reports. An annual and half yearly report is also made to Council.

4. The Council receives independent treasury advice from Arlingclose.

Current Position

5. On borrowing our current approach is:

   (1) No new borrowing is anticipated.

   (2) As well as budgetary constraints the key issue in not borrowing is the cost of cost ie. the difference between the cost of borrowing and interest on deposits.

   (3) £77m of loans which matured in 2012/13 were repaid rather than refinanced.

6. On investments our current approach is:

(1) Cash deposits, call accounts and Certificates of Deposit (CDs) with the following UK Banks and Building Societies systematically important to the UK economy:

- Barclays
- HSBC
- Lloyds Banking Group
- Royal Bank of Scotland
- NatWest
- Santander UK
- Standard Chartered
- Nationwide

And Treasury Bills and Debt Management Office deposits. Deposits in a number of Australian and Canadian banks are permitted but none have been made.

(2) Duration of deposits run from 12 months with Standard Chartered to overnight with RBS and NatWest

7. The current approach to investments has a number of issues:

(1) Deposit rates are reducing and are likely to reduce further – banks are reducing deposit rates because of the Government's Funding for Lending Scheme which allows them to access cheap finance from Government. There are only a small number of counterparties with whom we can achieve a rate over 0.5%.

(2) Bank downgrades – rating agencies continue to downgrade financial institutions and some are now close to our A- minimum.

(3) Bail in risk – increasingly rather than "bailing out" failing financial institutions Government is looking for bond holders and potentially depositors to fund a rescue. Bond holders in the Cooperative Bank, which the Council does not use, will take a substantial financial loss in the bank's restructuring.

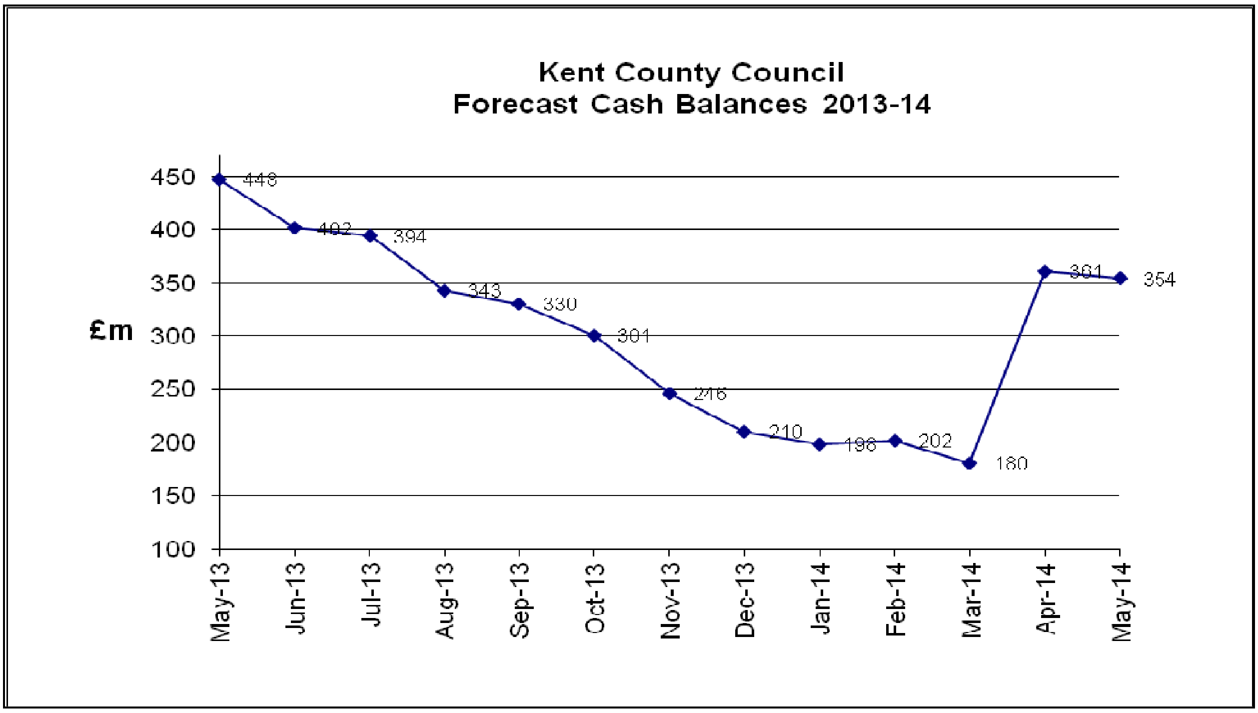
(4) Future ownership of RBS and Lloyds – these banks still offer the best deposit rates but as the Government divests ownership their credit ratings may reduce and we may not be able to use them.

(5) Limited diversification – only cash deposits, CD's, Treasury Bills and call accounts.

(6) Shortfall on investment income budget – the budget of £2.7m will not be achieved this year although it is offset by savings elsewhere in the Financing Items budget.

Options for Change

8 The cashflow projection for 2013/14 is shown below.



With the front loading of Revenue Support Grant the early part of the year has seen balances of well over £400m which we project will reduce to a minimum of around £200m.

9. The monies available to invest have two main characteristics:

(1) Transactional cash – true cashflow which should be deposited short term and be liquid.

(2) Core cash – essentially reserves and other longer term monies where there is potential for longer duration deposits and less requirement for liquidity.

10. Given the Council's overall financial position and the issues set out in paragraph 7 it is important that we explore all options for generating additional income, including investment income. We believe that we can generate higher investment returns by broadening the type of funds which we invest in. Effectively we would look to create an investment portfolio of relatively low risk, diversified funds which would be towards the lower end of the risk horizon of the Pension Fund. This would initially be for around £75m but with investments looking to return 4-8% or £3-6m per annum.

11. It is envisaged that this would be a well diversified portfolio. Each investment would be subject to detailed due diligence and advice taken from Arlingclose or the Pension Fund investment consultants Hymans Robertson.

It would be efficient to make use of due diligence already undertaken by the Pension Fund.

12. Officers have already undertaken substantial research on options and four main areas have been identified:

(1) **Absolute Return Funds**

Pooled funds investing in a range of asset types including equities, fixed income and alternatives. These funds typically aim to return Cash +5% and put an emphasis on capital protection. They may lose capital value in times of market stress but it should be less than the market. The Pension Fund has £180m in an Absolute Return Fund with Pyrford which just invests in equities, fixed income and cash.

(2) **Equity Income Funds**

Either UK or Global funds focussing on companies which produce strong income i.e. dividend returns. Again likely to underperform equity market returns generally but have less volatility. There are a number of large well known funds which would be investable.

(3) **Property Pooled Funds**

Again we would look at very large well established balanced funds and funds with high covenant and long leases linked to RPI. The only disadvantage is that investment in such funds would have to be specifically via capital receipts. We could invest cash directly in the small CCLA Local Authority Property Fund which has a specific CLG exception.

(4) **Other**

Opportunistic investments potentially linked to local economic regeneration projects. Again these would need to be low risk and securitised.

13. We would need to be clear about the potential downsides of this approach:

(1) Risk of loss of capital – this would be countered by due diligence and diversification within the investment portfolio:

(2) Volatility in returns – but with returns at a much higher level than on cash deposits.

(3) Illiquid – this would be manageable as the investment portfolio would be relatively small compared with the aggregate of deposits.

14. The approach was discussed at the Treasury Advisory Group on 31 July with Arlingclose present and the group was supportive of the approach.

15. Recommendation(s)

That Cabinet agree to:

(1)	Establish a core investment portfolio of £75m with a maximum exposure to any one investment of £5m.
(2)	Delegate responsibility for the selection of investments to the Corporate Director of Finance & procurement in consultation with the Deputy Leader & Cabinet Member for Finance & Procurement.

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