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| From: | **John Simmonds, Deputy Leader & Cabinet Member for Finance & Procurement**<br><br>**Andy Wood, Corporate Director of Finance & Procurement** |
| To: | **Cabinet – 2 June 2014** |
| Subject: | **Treasury Strategy Update** |
| Classification: | **Unrestricted** |


**Summary**: To propose revisions to the Council's treasury strategy.


**Recommendation(s)**: Cabinet is asked to:

(1) Increase the Svenska Handelsbanken limit to £40m.

(2) Increase the allocation to Covered Bonds to £100m in aggregate with a £20m limit by institution.

(3) Increase the maximum investment in the CCLA LAMIT Property Fund to £10m.

(4) Introduce Corporate Bonds with a maximum individual limit of £5m.

(5) Introduce Bond Funds with a maximum investment in any one fund of £5m within the investment portfolio aggregate limit of £75m

## Introduction

1. The Annual Treasury Strategy is agreed by Council at its February meeting as part of the budget report. The strategy covers the cashflow management, borrowing and investment policies which will be followed in managing the Council's cashflow and reserves.

2. Treasury management is highly regulated and activities need to comply with regulatory requirements set out by the Financial Conduct Authority and the Prudential Regulations Authority (the successors to the Financial Services Authority), Department of Communities and Local Government Guidelines and the mandatory Chartered Institute of Public Finance and Accountancy Code of Practice on Treasury Management.

3. Within the Council, an all party sub-group of Cabinet, the Treasury Management Advisory Group (TMAG), has an advisory role to the Deputy Leader and Cabinet Member for Finance & Procurement and the Corporate Director of Finance & Procurement. Any in year changes to the agreed strategy need to be agreed by Cabinet.

4. The Council receives independent treasury advice from Arlingclose.

**Reasons for Change**

5. Whilst the strategy was only agreed 4 months ago it has become apparent that there is a need for even greater diversification away from traditional cash deposits into other asset classes. The reasons for this are:

    (1) All cash deposits are subject to "bail in" rule ie in the event of a solvency issue for an institution depositors potentially will take a loss. This reflects changes of Government policy in the UK, US and EU with sovereigns seeking an alternative to "bail out" by Government.

    (2) To reduce exposure to any one financial institution the counterparty limits were reduced for banks to a maximum of £40m. This means that we have capacity issues given the level of Cash held.

    (3) In February the Royal Bank of Scotland / National Westminster Bank was downgraded by Moody's and no longer meets our credit rating requirement. So their use has been suspended thus losing £40m of capacity.

    (4) Deposit rates paid continue to reduce reflecting the lack of need for short term deposits by the banks and this is reinforced by regulatory requirements which increase the provisioning they need to make for such deposits.

    (5) New asset classes, such as Covered Bonds, introduced in February are providing attractive returns and at low risk but limits on them need to be increased.

    Underlying this is the need for higher returns at potentially the same or lower level of risk to support the Council's budget.

6. In September Cabinet agreed to establish an investment portfolio of up to £75m in total with a limit on any one investment of £5m. The asset classes identified were equity pooled funds, property funds, absolute return funds and local initiatives. To date three investments have been made totalling £12.7m. The constraints on expanding this portfolio are:

    (1) With equity markets close to record highs the pricing does not look attractive.

    (2) Except for the CCLA LAMIT Property Fund any investment in property funds has to count as capital expenditure. With capital resources needed to support the capital programme this is not feasible.

    (3) Absolute return funds invest predominately in equities. At this stage only one investment has been made.

(4) Local initiatives are largely opportunistic and again only one opportunity has been taken.

The investment portfolio does offer long term opportunities but good timing of investment decisions is vital.

**Proposed Changes**

7. Increase in the limit of Svenska Handelsbanken – as our first European bank the limit was set at half of that of UK banks ie £20m. Svenska Handelsbanken is highly rated and Arlingclose recommend them for their longest duration limit 12 months – a sign of their strength. It is therefore proposed to increase their limit to £40m.

8. Increase in the allocation to Covered Bonds – Covered Bonds are bonds issued by banks and building societies that are backed by a pool of assets eg. Mortgages and they have no Bail In risk. This means that the investor has dual recourse to both the issuing bank and the underlying pool of assets. The February strategy set an aggregate limit of £20m. It is now proposed to set a limit on an individual counterparty of £20m and an aggregate limit £100m. The investment in a Covered Bond issued by, say Lloyds, would count on top their counterparty limit of £40m giving a total potential exposure of £60m. Rates paid are substantially higher than deposits, so for example a recent £3m bond purchase with a large building society is paying 1.922% until 2018 compared with circa 0.5% for better deposit rates. .

9 CCLA LAMIT Property Fund – this is the only property fund which Councils can invest in without it counting as capital expenditure. The Fund is performing well and continues to grow as more local authorities seek an exposure to Property. The Fund currently stands at just over £131m and our target is to not hold more than 5% allocation of the total fund. It is proposed that the limit is increased to £10m but funds will only be committed as the total fund grows.

10. Introduce short term (less than 1 year) Corporate Bonds – Corporate Bonds are debt issued by major institutions. Purchasers would be limited to £5m in any one institution with a minimum credit rating of A from Standard & Poor's or equivalent. As with Covered Bonds the Treasury Team would identify buying options from discussion with brokers, get a view from Arlingclose and then make a buy recommendation to the Deputy Leader and Cabinet Member for Finance & Procurement and the Corporate Director of Finance & Procurement.

11. Introduce Bond Funds to the investment portfolio – increasingly bonds are seen as a way of generating an absolute return for investors by investing in a wide range of different types of asset. These are not funds which hold large amounts of Government bonds. At this stage we are seeking agreement in principle and no investment will be made until TMAG has done further due diligence.

**Reporting**

12. To ensure transparency around our treasury management activities the following reporting arrangements are in place:

- Weekly report on investments to TMAG.
- Monthly performance report to TMAG.
- Quarterly reporting to Governance & Audit Committee.
- Twice yearly reporting to Council.

**13. Recommendation(s)**

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Members are asked to agree to:

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(3) Increase the maximum investment in the CCLA LAMIT Property Fund to £10m.

(4) Introduce Corporate Bonds with a maximum individual limit of £5m.

(5) Introduce Bond Funds with a maximum investment in any one fund of £5m within the investment portfolio aggregate limit of £75m

**16. Contact details**

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