Council	Agenda Item 92
19 April 2018	Brighton & Hove City Council

Subject:		**Treasury Management Strategy Statement 2018/19 (Incorporating Annual Investment Strategy)**	
Date of Meeting:		**19 April 2018** 29 March 2018 – Policy, Resources & Growth Committee	
Report of:		**Executive Director of Finance & Resources**	
Contact Officer:	**Name:**	**James Hengeveld**	**Tel: 01273 291242**
	Email:	**James.hengeveld@brighton-hove.gov.uk**	
Ward(s) affected:		**All**	

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 Part 1 of the Local Government Act 2003 requires each local authority, inter alia, to:

- comply with the requirements of 'the Code of Practice for Treasury Management in the Public Services' issued by CIPFA; and
- comply with investment guidance issued by the Secretary of State

1.2 The Code of Practice requires each local authority to set out its strategy on treasury management for the forthcoming year. Additionally, guidance issued under the Local Government 2003 requires a local authority to approve an annual investment strategy. The purpose of this report is to recommend a Treasury Management Strategy Statement (TMSS - formerly called the Treasury Management Policy Statement), Treasury Management Practices and Annual Investment Strategy for the financial year commencing 1 April 2018.

1.3 At its meeting in March 2017, Policy, Resources & Growth Committee approved both the Treasury Management Statement and Treasury Management Practices for 2017/18 and subsequent years. There are no changes recommended to the Statement or Practices.

1.4 This year, this Committee is asked to recommend all three of the afore-mentioned strategies to full Council for its approval. This is in line with best practice and in preparation for submitting the report alongside the Budget Report in 2019/20 onwards.

2. RECOMMENDATIONS:

2.1 That Policy, Resources & Growth Committee recommends that full Council approve the TMSS and Treasury Management Practices, which remain as approved by Policy, Resources & Growth Committee on 23 March 2017.

2.2 That Policy, Resources & Growth Committee recommend that full Council approve the Annual Investment Strategy 2018/19 as set out in Appendix 2 to this report.

2.3 That Policy, Resources & Growth Committee recommends that full Council approve the Borrowing Strategy as set out in Appendix 3 to this report.

3. CONTEXT/ BACKGROUND INFORMATION

Background

3.1 The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested into counterparties and instruments commensurate with the council's risk appetite.

3.2 The second main function of the treasury management service is the funding of the council's capital plans. The capital plans provide a guide to the borrowing need - which is essentially the longer term cash flow plan - to ensure the council can meet its capital spending obligations.

3.3 The recommended TMSS follows the drafting format recommended in the Treasury Management Code of Practice. The Treasury Management Practices and schedules identify the practices and procedures that will be followed to achieve the aims of the TMSS and that underpin the council's Treasury Management function. These practices remain unchanged from previous years and are considered 'best practice' under the Code.

Reporting Requirements

3.4 The Council is currently required to receive and approve, as a minimum, three main reports each year which incorporate a variety of treasury policies, estimates and actuals.

3.5 At the beginning of the year, the authority is required to receive and approve:

- The treasury management strategy (how the investments and borrowings are to be managed) including treasury indicators;
- An Annual Investment Strategy (the parameters on how investments are to be managed);
- The council's capital plans (including prudential indicators);
- The Minimum Revenue Provision (MRP) policy (how residual capital expenditure is charged to the revenue account over time).

The first two outlined above are contained in this report. The prudential and treasury indicators, MRP Policy and capital plans were approved by Budget Council on 22 February 2018. The prudential and treasury indicators are replicated in Appendix 3 of this report.

3.6 Two further reports will update members with the mid-year and end of year progress of the performance of the treasury management function.

3.7 The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by Policy, Resources & Growth committee.

Changes to the Prudential Framework

3.8 The council undertakes its borrowing and investment decisions in accordance with the four statutory codes which make up the Prudential Framework. Each of these four codes has recently been updated following consultation with Local Authorities. CIPFA released revised Prudential and Treasury Management Codes in December 2017, and the Ministry for Housing, Communities and Local Government released revised Investment Guidance and MRP Guidance in February 2018.

3.9 The Prudential Framework has primarily been revised to improve the transparency and accountability of local authority investments, particularly in non-financial commercial investments such as commercial property and loans to third parties. The aim is to ensure members are fully conversant with the risks of non-financial investments and are aware of how the risks are proportional to the council's revenue position and other capital and borrowing activity. The major changes to implement are as follows:

- **Capital Strategy:** All local authorities will be required to prepare an additional report called a Capital Strategy report, which is intended to provide the following: -

  - a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
  - an overview of how the associated risk is managed;
  - the implications for future financial sustainability.

  The aim of this report is to ensure that all elected members fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy.

  The Capital Strategy will include capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

- **Treasury Management Role of the Section 151 (S151) Officer:** The specific responsibilities of the S151 officers have not been revised under the code's revision. However, as the codes have been extended to cover non-financial investments (which CIPFA have defined as being part of treasury management), it is implicit that there has been an extension of these responsibilities to cover non-financial investments.

- **Implementation:** CIPFA have issued a statement requiring full implementation by 2019/20 but with adoption recommended as early as possible. A Capital Strategy which is compliant with the code's new requirements will be drafted. Additionally, changes may need to be made to the Treasury Management Practices & Schedules and the Council's Financial Regulations and Procedures. Officers are working towards having these requirements in place during 2018/19, with changes to be agreed alongside the 2018/19 Treasury Management Mid-Year Review.

Annual Investment Strategy

3.10 The Annual Investment Strategy (AIS) for 2018/19 is set out in Appendix 2 to this report. The AIS gives priority to security and liquidity.

3.11 Security is achieved by:

- selecting only those institutions that meet stringent credit rating criteria or, in the case of non-rated UK building societies, have a substantial asset base; and
- limiting the amount invested with any one institution.

3.12 The council uses independent credit rating agencies to assess the creditworthiness of investment counterparties. Aside from some specific exemptions (as set out in 1.3.3 of Appendix 2), the AIS 2018/19 continues with the policy of assessing creditworthiness by applying the lowest rating issued by the three main rating agencies – Fitch, Moody's, and Standard & Poor's. In the majority of cases the ratings issued by these agencies are aligned but this is not always the case**.**

3.13 Rating criteria are only one factor taken into account in determining investment counterparties. There are other factors such as:

- counterparty Credit Default Swap prices **-** traded financial derivatives that are essentially "insurance" against a counterparty's debt; the price trends of these instruments provide some insight as to how the market views the risk of a particular counterparty;
- credit watches;
- outlooks published by the ratings agencies;
- articles in the financial press.

3.14 Action will be taken where it is felt the risk attached to a particular counterparty has or is likely to deteriorate. Action will include the temporary suspension of the counterparty if considered appropriate.

3.15 Liquidity is achieved by limiting the maximum period for investment and matching investment periods to cash flow requirements.

Changes to the AIS for 2018/19

Externally managed investments (Cash Manager)

3.16 During 2017/18 there has been a change in the council's relationship with the cash managers (Aberdeen Asset Management). The council now invests directly into Aberdeen's AAA Ultra Short Dated Bond Fund as opposed to having a segregated mandate for investment. This does not change the risk or return of the funds invested with Aberdeen as the council's money was already held in this fund. The segregated Cash Manager mandate was originally set up to allow the cash manager to invest directly into other instruments such as gilts. However, in reality as the markets changed following the financial crisis, this mandate was never utilised.

As a result, references to the Cash Manager's investment parameters have been deleted from the Annual Investment Strategy as this is no longer relevant. The investment is being treated as an investment into an Ultra Short Dated Bond fund (previously called Enhanced Money Market funds in previous AIS documents).

Fund Selection Process

3.17 In order to maximise the council's investment return within appropriate security and liquidity parameters, it is important to match investment time horizons with cash needs. A balance sheet review has been undertaken which has identified that up to £20 million of the council's reserves are expected to be long term reserves and can therefore be invested for a time horizon of up to 5 years. Additionally, up to £20 million has been identified as being available for investment for a time horizon of up to 3 years in line with cash flow forecasts.

3.18 Furthermore, it has been a number of years since the performance of the Aberdeen fund has been tested against other similar funds. The performance of Aberdeen has fallen over the last couple of years, which has presented a good opportunity to review the performance through the undertaking of a selection process for Ultra Short-dated Bond funds.

3.19 Working with the council's treasury advisors, treasury officers are expecting to place up to £30 million across a small number of funds. This incorporates the £20 million of longer term reserves as well as a further £10 million which can be safely invested for a 2/3 year time horizon in line with cash flow forecasts.

3.20 Link Asset Services has been engaged to assist in a selection process of two types of funds as set out below. The purpose of investing in two different types of fund is to ensure diversification and allow the council to improve its return on investments whilst minimising the risk of capital loss. Both types of funds are already allowable within the council's investment strategy.

- **Ultra Short Dated Bond Funds:** These pooled investment funds are typically invested only in high quality, investment grade instruments. The funds are highly diversified and very liquid and most are rated by the ratings agencies. The funds vary in terms of what assets they invest in, and the recommended investment time horizon varies, from just a few weeks to one year. The council already invests £26 million in the Aberdeen Ultra Short-dated bond fund. Officers expect to invest up to £20 million across up to two funds.
- **Short Dated Bond Funds:** These funds are also pooled investment vehicles. One evident way these funds differ from the Ultra Short dated funds in that they are largely unrated by the ratings agencies and therefore a greater level of due diligence is required to fully understand the parameters under which they invest. The investment time horizon is longer too, with most funds having a minimum investment time horizon of 2-3 years. The longer term nature of the assets within the fund means that the fund's performance can be more volatile than the Ultra Short Dated fund. Officers will undertake a detailed selection process which will include detailed assessments of a range of different aspects of each fund. These will include the underlying investment process, the experience of the fund management company, permitted instruments, past performance, including volatility, and an understanding of the ethical approach associated with each fund. These assessments will be undertaken following receipt of responses to a detailed questionnaire that will be sent to each fund manager deemed appropriate at the start of the process. Officers expect to invest up to £20 million across up to two funds.

Money Market Fund Reform

3.21 The council uses Money Market Funds (MMFs) as its primary means of achieving liquidity within its investment portfolio. The funds that the council currently invests in are funds which use a Constant Net Asset Value (CNAV) pricing method. As reported within the 2017/18 Annual Investment Strategy report in April 2017, new EU regulations for reforming MMFs are coming into force on 1 January 2019. The changes will limit the activity and structure of

CNAV funds to just those which invest solely in government-level securities. As a result, many fund managers will be modifying their non-government MMF structures to LVNAV (Low Volatility Net Asset Value) or VNAV (Variable Net Asset Value). The strategy has been amended to allow the council to invest in all three fund types: up to £10m per AAA rated fund.

Bank Ring-fencing

3.22 The government introduced has new ring-fencing legislation which comes into effect from 1 January 2019. Under this legislation large banks (those which hold retail and SME deposits over £25bn) are required to separate out core retail banking activities from their investment and international activities. This is a response.to the global economic crisis to improve the resilience of banks.

3.23 There are currently 5 UK banks which will be subject to the ring-fencing requirements: the RBS Group, the Barclays group, the Lloyds Banking Group, the HSBC group and Santander UK will therefore be splitting their operations out into two banks. In the majority of cases, the relationship that the council has with these banks will operate within the ring-fence. Where this is not the case, deposits will only be placed with banks where they meet the council's investment strategy parameters.

3.24 Where the RBS group is currently treated as having part national status in accordance with 1.3.3 of the AIS (Appendix 2), from 1 January 2019 only the ring fenced part of the group will be treated in this way.

Borrowing Strategy

3.25 The Borrowing Strategy is largely determined by the borrowing needs of the council and forecasts of future interest rates. An up-to-date economic analysis and the latest interest rate forecasts are presented in Appendix 1 to this report.

3.26 The Borrowing Strategy, as set out in Appendix 3, focuses on reconciling the benefit of undertaking low cost long term funding with the short term cost of carrying additional debt in a low investment rate environment.

Treasury management controls & governance

3.27 The treasury management service is subject to detailed audit each year. This includes the testing of the control environment and the management of risk. A substantial assurance level was the assessed result of the most recent audit in December 2017.

3.28 Paragraphs 3.4 to 3.6 of this report set out the reporting and scrutiny requirements for Treasury Management.

3.29 Appendix 4 sets out the current scheme of delegation for treasury management.

Training & Qualifications

3.30 External training courses for the treasury management team will be considered for value and benefit. Records of individual training will be kept in accordance with the procedures introduced by the council for such purposes. Career development and succession arrangements will also be in accordance with council policy on such arrangements.

3.31 Details of the qualifications for treasury staff are set out in the job descriptions and person specifications appertaining to each post. Secondments (if any) will be recorded in accordance with council policy on such instances.

Member training on treasury management is seen as an important tool in the scrutiny of the service. A course which gives an overview of treasury management ("An introduction to treasury management") is available. The course explains what treasury management is, the aims and objectives of the service, and an understanding of the key risks, including investment risk.

Use of Advisors

3.32 The council currently uses Link Asset Services as its external treasury advisors. The advisors are expected to be proactive in analysing information to assist the in-house treasury team to meet its targets on the cost of long-term borrowing and investment returns, and to advise on developments in the sector.

3.33 The council recognises that responsibility for decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to access specialist skills and resources.

3.34 The contract with Link Asset Services was awarded in November 2015 utilising a public sector framework. This contract is for three years to November 2018. A procurement process will be undertaken during 2018/19 to procure a new treasury advisory contract.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 This report confirms there are no changes to the TMSS approved by the Policy, Resources & Growth Committee last year. The Strategy continues with a strong emphasis on risk management and the impact this may have on the performance of the treasury management service.

4.2 The AIS continues with the strong emphasis on risk management and liquidity, two cornerstones to the draft guidance issued by the Secretary of State, and the impact these have on investment performance.

5. COMMUNITY ENGAGEMENT & CONSULTATION

5.1 The council's external treasury advisors have been consulted in the drafting of this report.

6. CONCLUSION

6.1 Treasury management is governed by a code that is recognised as "best and proper practice" under the Local Government Act 2003. The code requires local authorities to report annually in advance on their treasury management plan and strategy. This report fulfils this requirement.

6.2 Additionally, the 2010 investment guidance requires that local authorities produce an investment strategy to be approved and amended by full Council. This report fulfils both of these requirements.

7. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

7.1 The Financing Costs budget has been prepared on the basis of the borrowing strategy set out in Appendix 3, the annual investment strategy set out in Appendix 2 and the interest rate forecasts and economic forecast set out in Appendix 1.

Finance Officer Consulted: James Hengeveld Date: 06/03/2018

Legal Implications:

7.2 This report is made in accordance with Part 1 of the Local Government Act 2003, which provides local authorities with a wide power to borrow up to the affordable limit, as well as to invest subject to limits provided for by regulations. The 2003 Act requires local authorities to follow proper practices in relation to their accounting practices. Regulation 31 of the Local Authorities (Capital Finance and Accounting) (England) Regulations (as amended) specifies the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom and Service Reporting Code of Practice for Local Authorities as the proper practices. The powers to borrow and invest are to be exercised subject to the restrictions and guidance indicated in this report.

7.3 It is a proper function of Policy, Resources & Growth Committee to review the council's TMPS and Borrowing Strategies, and to formulate the Annual Investment Strategy prior to their consideration by full Council.

Lawyer Consulted: Victoria Simpson Date: 13/03/2018

Equalities Implications:

7.4 No equalities impacts have been identified in relation to this report.

Sustainability Implications:

7.5 The council's ethical investment statement requests that institutions apply council deposits in a socially responsible manner. Ethical options were considered in the report to 12 July 2012 Policy & Resources Committee

Any Other Significant Implications:

Risk & Opportunity Management Implications:

7.6 The investment guidance issued under the 2003 Act requires the council to assess credit worthiness by reference to an independent rating agency. The AIS 2018/19 will use the ratings assigned by Fitch, Moody's and Standard & Poor's.

7.7 The ratings provide an opinion on the relative ability of an institution to meet financial commitments, such as interest, preferred dividends, repayment of principal, insurance claims or counterparty obligations. The council uses credit ratings as an indication of the likelihood of receiving its money back in accordance with the terms of the investment. Other sources of information are also used to supplement that provided by the rating agencies.

7.8 The minimum ratings set out in the AIS have the following meaning:

	Generic criteria	Fitch	Moody's	Standard & Poor's
For investment up to 1 year				
Short-term	Good capacity for timely payment of financial commitments. Where the credit risk is particularly good, a "+" is added to the assigned rating by Fitch and S&P	F2	P-2	A-2
For investment in excess of 1 year				
Long-term	Strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	BBB	Baa	BBB

7.9 Investment risk is managed by selecting only institutions that meet the council's stringent credit rating criteria. Liquidity risk is managed by applying maximum investment periods to institutions.

SUPPORTING DOCUMENTATION

Appendices:

1. Economic Outlook and Interest Rate prospects
2. Annual Investment Strategy 2018/19
3. Borrowing Strategy and Indicators 2018/19
4. Treasury Management Scheme of Delegation

Documents in Members' Rooms

None

Background Documents

1. Part I of the Local Government Act 2003 and associated regulations

2. Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes' published by CIPFA third edition 2011

3. 'Treasury Management in the Public Services – Guidance notes for local authorities ... " published by CIPFA fourth edition 2011

4. 'The Prudential Code for Capital Finance in Local Authorities' published by CIPFA third edition 2011

5. Brighton & Hove City Council Anti-Money Laundering Policy approved by full Council on 19 January 2006

6. Guidance issued by the secretary of State under Section 15(1)(a) of the Local Government Act 2003 effective from 1 April 2010