Treasury Management and Investment Sub-Committee Agenda

14 December 2020 at 7pm

Remote Meeting

Membership

Councillor C.K. Davidson (Chair)

and Councillors

M.W. Bracken, D.J.R. Clark, P.H. Clark, J. Galley, A.B. Sosin and R.T. Whitehead

Local people are welcome to attend this meeting, where your elected Councillors take decisions affecting YOU and your City. There will also be an opportunity to ask your Councillors questions or make a statement. These have to be submitted in advance and details are on the agenda page. If you would like to find out more, please telephone Daniel Bird
in the Democracy Team on Chelmsford (01245) 606523
email Daniel.bird@chelmsford.gov.uk

Treasury Management and Investment Sub Committee

14 December 2020

AGENDA

1. Apologies for Absence and substitutions

2. Minutes

To consider the minutes of the meeting held on 20 October 2020

3. Declaration of Interests

All Members are reminded that they must disclose any interests they know they have in items of business on the meeting's agenda and that they must do so at this point on the agenda or as soon as they become aware of the interest. If the interest is a Disclosable Pecuniary Interest they are also obliged to notify the Monitoring Officer within 28 days of the meeting.

4. Public Question Time

Any member of the public may ask a question or make a statement at this point in the meeting. Each person has two minutes and a maximum of 15 minutes is allotted to public questions/statements, which must be about matters for which the Committee is responsible.

The Chair may disallow a question if it is offensive, substantially the same as another question or requires disclosure of exempt or confidential information. If the question cannot be answered at the meeting a written response will be provided after the meeting.

Any member of the public who wishes to submit a question or statement to this meeting should email it to committees@chelmsford.gov.uk 24 hours before the start time of the meeting. All valid questions and statements will be published with the agenda on the website at least six hours before the start time and will be responded to at the meeting. Those who have submitted a valid question or statement will be entitled to put it in person at the meeting, provided they have indicated that they wish to do so and have submitted an email address to which an invitation to join the meeting and participate in it can be sent.

5. Treasury Management & Investment Strategies 2021/22

6. Urgent Business

To consider any other matter which, in the opinion of the Chair, should be considered by reason of special circumstances (to be specified) as a matter of urgency.

MINUTES

of the

TREASURY MANAGEMENT AND INVESTMENT SUB COMMITTEE

held on 20 October 2020 at 7.00pm

Present:

Councillor C.K. Davidson (Chair)

Councillors M.W. Bracken, D.J.R. Clark. P.H. Clark, J. Galley. A.B. Sosin, R.T Whitehead

1. Apologies for Absence and Substitutions

No apologies for absence were received.

2. Minutes

The minutes of the meeting held on 22 June 2020 were agreed as a correct record and signed by the Chair.

3. Declaration of Interests

All Members were reminded to declare any Disclosable Pecuniary interests or other registerable interests where appropriate in any items of business on the meeting's agenda. None were made.

4. Public Question Time

No questions were asked or statements made.

5. Treasury Management Mid-Year Review 2020-21

In accordance with the CIPFA Code of Practice the mid-year review of the Council's treasury management function and activites in 2020/21 was presented to the Sub-Committee. The review examined the position with the Council's investments at 31 August 2020 and compared treasury activity to the approved Treasury Management Strategy. The Sub-Committee was asked to consider whether any amendments to the Strategy were necessary and, if so, to recommend them to Cabinet on 17 November and then Full Council on 9 December 2020.

The Committee was informed by officers that no changes to the strategy were being recommended and were directed to the executive summary on page 11 of the agenda pack. It was noted that there had been no breaches of the strategy and all transactions had been compliant but that interest rates had fallen dramatically across the year. The Committee heard that no external borrowing had been required to fund the capital programme and this had instead been achieved by using existing cash balances. The Committee was also informed that due to Covid there was some risk of the potential to need to borrow externally but this had not been the case yet. Officers also informed the Committee that some investments were now paying negative interest rates and at this time, Arlingclose had not recommended any new investments or disposals.

Councillor P Clark raised his concerns on the continued investment in the CCLA property fund whilst its valuation was down and its unrealised profits had also fallen. He also noted that the fund had been closed for 90 days during lockdown and therefore the Council would not have been able to withdraw its funds. He stated that he had always held concerns on the fund and the current figures demonstrated the risks involved in continued investment. Other members of the Committee also acknowledged the downturn in performance of the CCLA property fund but noted that this was unfortunately to be expected in the current climate and it was still a considerably better option, than some of the negative interest rates that were on offer elsewhere. It was also noted by other members of the Committee that it had still been providing an income whereas many other funds would not in the current financial climate. Members of the Committee also noted that it was not the Council's only treasury investment and did not represent a large part of the overall cash invested by the Council but if it had been then there could be a stronger argument for no longer investing in the fund.

Officers informed the Committee that it was correct the fund had not been performing as well as previously but it was a medium-term investment and the advice from the Council's Treasury advisors was to continue to hold funds and to ride out the current volatility. The Committee was informed that it was a balanced risk but at the current time this was the advice from the Council's Treasury advisors. Officers also confirmed that it was not a fund you could easily move in and out of due to penalty charges that would be applied as a result.

On being put to a vote, the majority of the Committee agreed the recommendations as detailed in the report. Councillor P Clark voted against the recommendations.

RESOLVED that;

1. the Treasury Management Mid-Year Review report be recommended to Cabinet and;
2. that no changes are made to the Treasury Management Strategy.

(7.03pm to 7.21pm)

6. Urgent Business

There were no matters of urgent business to discuss.

Exclusion of the Public

Resolved that under Section 100A (4) of the Local Government Act 1972 the public be excluded from the meeting for Item 7 on the grounds that it involved the likely disclosure of exempt information falling within paragraph 3 of Part 1 of Schedule 12A to the Act.

7. Non-Treasury Investments – Monitoring and Strategy Development

The Committee considered a report, providing an update in respect of the Council's non-cash investments, following on from the initial discussion at the meeting in June 2020 on the topic. The report detailed the information agreed as monitoring criteria in June 2020 along with a brief update on all sales and purchases from the Council's other property holdings and a list of the Council's assets and valuations.

The Committee agreed that the information had been very useful and would allow them to monitor the area effectively. It was noted though that some assets had not been included, it was therefore agreed that officers would clarify what the list detailed and that it had not been intended to be a comprehensive list of all assets. It was noted that this would be clarified at the next meeting.

RESOLVED that

1. the report and appendices be noted and;
2. further clarity to be provided at a future meeting on which assets are included for monitoring.

(7.22pm to 7.40pm)

The meeting closed at 7.40pm.

Chair

Chelmsford City Council Treasury Management and Investment Sub-Committee

14th December 2020

Treasury Management & Investment Strategies 2021/22

Report by:

Director of Financial Services

Officer Contact:

Phil Reeves, Accountancy Services Manager, phil.reeves@chelmsford.gov.uk, 01245 606562

Purpose

To recommend Treasury Management and Investment Strategies for 2021/22 to Cabinet and then Full Council

Options

1. Accept the strategies
2. Recommend changes to the way by which the Council's investments are to be managed

Recommendation

Recommend the Treasury Management and Investment Strategies to Cabinet

1. Background

1.1 Cabinet and Council are legally responsible for approving the Treasury Management and Investment Strategies. The attached report enables the subcommittee to recommend to Cabinet and Council Treasury Management & Investment Strategies for 2021/22.

1.2 Members of the sub-committee are able to amend the contents of the attached report and thereby recommend changes to how the Council invests its money.

List of appendices:

Draft Cabinet Report and Appendices

Background papers:

None

Corporate Implications

Legal/Constitutional: None

Financial: As detailed in report.

Potential impact on climate change and the environment: The Council's Climate and Ecological Emergency Action Plan as agreed at Cabinet 28th January 2020 included review of the Council's investment strategy in light of the Climate and Ecological Emergency Declaration.

Contribution toward achieving a net zero carbon position by 2030: As above

Personnel: None

Risk Management: All investment activities require a careful consideration of risk and reward.

Equality and Diversity: None

Health and Safety: None

Digital: None

Other: None

Consultees: None

Relevant Policies and Strategies:

Chelmsford City Council Cabinet

26th January 2021

Treasury Management & Investment Strategies 2021/22

Report by:
Cabinet Member for a Fairer Chelmsford

Officer Contact:
Phil Reeves, Accountancy Services Manager, 01245 606562, phil.reeves@chelmsford.gov.uk

Purpose

To recommend an approach for managing the Council's:

- Cash and
- Other types of investment including property

Options

1. Accept the recommendations contained within the report
2. Recommend changes to the way by which the Council's investments are to be managed

Preferred option and reasons

Recommend the report to Council without amendment for consideration and thereby meet statutory obligations.

Recommendations

That Cabinet requests that Full Council approve the Treasury Management and Investment Strategies.

1. Background

1.1. The activities around the management of the Council's cash and external borrowing are known as Treasury Management.

1.2. Under statute and the CIPFA Code of Practice on Treasury Management ("the Code"), members are required to receive reports on the Council's Treasury Management (TM) activities. The report in **Appendix 1** complies with the Code and relevant Government regulations.

1.3. Full Council has overall responsibility for the Treasury Strategy but delegates to the Treasury Management and Investment Sub-committee responsibility to monitor activity and recommend changes to strategy. The Director of Financial Services has been delegated responsibility to manage operational TM activities within the approved strategy.

1.4. The Ministry of Housing, Communities and Local Government requires the Council to publish and have approved an Investment Strategy. This covers investments that are deemed not to be Treasury Management Activities. The Investment Strategy is in **Appendix 2**.

1.5. Members of the Treasury Management & Investment Sub-Committee have reviewed the contents of this report and recommended that the Cabinet note its contents and seek Council approval for the Strategies.

2. Executive Summary

Treasury Strategy

Investments

- Cashflow and investment balances are more difficult to predict because of COVID-19.
- It is proposed to have a target of at least £15m of liquid funds to manage cashflow during the year.
- No changes are recommended to how long the Council can invest or with which counter parties.
- There is a risk of negative interest rates which would mean the Council would effectively pay someone to hold Council cash investments.
- Cash available for investment will reduce as the Council intends to internally borrow to fund the capital programme.

Borrowing

- Borrowing will only be undertaken for temporary liquidity or to fund the capital programme.
- Recently HM Treasury has published details of new Public Works Loans Board (PWLB) lending terms reducing rates by 1% from 26 November 2020 but also confirming that it will not lend to an authority that plans to buy investment property primarily for yield anywhere in their capital plans. The Council will therefore no longer seek to purchase investment properties primarily for the return they provide.
- The Director of Financial Services under the constitution manages investments and borrowings. Current planning assumes internal borrowing will be the main source of funding, but the Director will externalise borrowing should it represent better financial value to the authority.
- Limits for borrowing will be set in the Capital Strategy which will be reported to Cabinet and then Council as part of the 2021/22 Budget.

Non-Cash Investments (Investment Strategy)

- It is recommended that no new commercial property investments will be made where the purpose of the investment is primarily for the yield. This will enable access to PWLB loans if required.
- The strategy has provision to allow for the creation of a stand-alone housing company.
- The monitoring of non-treasury investments is undertaken by the Treasury Management and Investment Sub-committee.

3. Conclusion

3.1. Cabinet is asked to recommend to Council the Treasury Management and Investment Strategies.

List of appendices:

Appendix 1 – Treasury Management Strategy 2021/22

Appendix 2 – Investment Strategy 2021/22

Background papers:

Nil

Corporate Implications

Legal/Constitutional: The report meets statutory obligations on reporting Treasury Management Activity

Financial: As detailed in the report

Potential impact on climate change and the environment:

Any fund managers will be required to consider ESG (Environmental, Social and Governance) factors in their investment process. All the fund managers would be expected to have signed up to the UN Principles for Responsible Investment (PRI). PRI argues that active participation in ESG and exercising shareholder rights on this basis can help to improve the performance of companies which may otherwise not address such concerns and so being an engaged corporate stakeholder is a more effective way to bring about change in corporate behaviour on ethical issues.

Further requirements from those identified above are not practical given the limited ability to directly influence any immediate change in the financial markets.

Contribution toward achieving a net zero carbon position by 2030:

N/A

Personnel:

N/A

Risk Management:

The report is part of the Council's approach to managing risks arising from Treasury Management

Equality and Diversity:

N/A

Health and Safety:

N/A

Digital:

N/A

Other:

Consultees:

Relevant Policies and Strategies:

Treasury Management Strategy

1.1 Chelmsford City Council complies with both the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes and the Ministry of Housing, Communities and Local Government's Guidance on Local Government Investments. Both the Code and MHCLG regulations require the Authority to prepare and authorise a Treasury Management Strategy prior to the start of each financial year. This report fulfils the Council's legal requirement under the Local Government Act 2003.

1.2 Treasury Management covers both borrowing and investment. Chelmsford City Council has substantial cashflows and investments from its activities and is therefore exposed to a series of financial risks including the loss of invested funds. Risk also comes from possible changes in interest rates affecting investment income or the cost of any external borrowings.

1.3 The Council's investment priorities, as required by Government regulations are, in order of priority:

(a) the security of capital

(b) the liquidity of its investments; and

(c) yield.

The Government regulations and CIPFA both advise that absolute certainty of security of capital and liquidity does not have to be achieved before seeking yield from investments. An appropriate balance of all three should be sought and that balance is determined by the Council in its Treasury Strategy.

1.5 It is important to note that the borrowing of monies purely to invest or lend on to make a return is unlawful and this Council will not engage in such activity. The borrowing of monies to fund the capital programme is allowed.

1.6 In the event of major changes to the external or internal context in which this strategy has been set, it may be necessary for the Council to revise its strategy during the year.

1.7 This Treasury Management Strategy will focus solely on investments arising from the organisation's cashflows and debt management activity and matters of borrowing. Non-treasury investments will be covered separately under the Investment Strategy (**Appendix 2**). The monetary limits on borrowing will be set in the Capital Strategy which forms part of the 2021/22 Budget papers going Cabinet and Council in the new calendar year.

2. External Context

2.1 The Council's Treasury Management Strategy operates in a macroeconomic environment which can have a significant impact on the Council's treasury operations in terms of inflation, interest rate and counterparty risks.

The economic environment and interest rate forecast

2.2 The impact on the UK from coronavirus, together with its exit from the European Union and future trading arrangements with the bloc, will remain a major influence on the Authority's Treasury Management Strategy for 2021/22.

2.3 The Bank of England (BoE) maintained Bank Rate at 0.10% in November 2020 and also extended its Quantitative Easing programme by £150 billion to £895 billion. The Monetary Policy Committee

voted unanimously for both, but no mention was made of the potential future use of negative interest rates. Within the latest forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast.
UK Consumer Price Inflation (CPI) for September 2020 registered 0.5% year on year, up from 0.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 1.3% from 0.9%. The most recent labour market data for the three months to August 2020 showed the unemployment rate rose to 4.5% while the employment rate fell to 75.6%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021.

The COVID-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Credit Outlook and counterparty risk

2.4 Over recent years the Council has reduced the amount of unsecured bank deposits it holds in reaction to the “bail in” risk arising from reform to the banking sector. Under “bail in” provisions, investors would face losses to their deposits and share-holdings in order to recapitalise a bank before any Government bailout would occur.

2.5 Public Bodies provide much less risk as investment counterparties but a balance between risk and return does allow the use of other types of investment counter party. The Council should, where possible, continue to spread investments over different organisations and different investment categories (property, pooled funds, public bodies, etc) to provide a satisfactory balance of security of capital and return.

3. Investment Balances and Potential External Borrowing

3.1 At the end of November 2020, the Council held £60m of investments. These investments arise from balances including unspent Community Infrastructure Levy (CIL) and reserves, as well as income received in advance of expenditure. Also, the Government’s support to Councils and Businesses has increased cash holding at least temporarily. The Council has been in receipt of significant sums from Government that can take a number of weeks to pay out. It is not expected that this level of investment balance will be retained beyond 2020/21.

3.2 During most months the cash balance can rise and fall by £10m due to receipt of income and payment of precepts to other Essex bodies. The Council should therefore aim to keep sufficient cash to hand to manage these fluctuations. Alternatively, it can undertake temporary borrowing, but will do so wherever possible in advance of need to ensure sufficient liquidity.
The financial year-end tends to be the lowest point for the Council’s cash balances. This is because most residents pay their Council Tax over 10 instalments, but the Council pays these out to central government and other precepting authorities on a monthly basis; so significant net cash outflows occur in February and March each year. The principles to establish how investments should be managed are discussed in Section 4 below.

3.3 The Capital Strategy published with the Revenue 2021/22 budget papers will include debt limits reflective of the 2021/22 budget.

The CFR (Capital Financing Requirement) is the amount of capital expenditure the Council has financed by (internal or external) borrowing. The budget report will update the forecast of the CFR. The current level of CFR reflects the decisions taken by Council to cease revenue contributions to capital in 2019/20 and 2020/21 which represents around £10m of extra CFR (borrowing).

The historic level of CFR is shown in the table below with the external and internal debt.

Temporary Use of Surplus cash	April 2020 £m's	Forecast March 2021 £m's
Capital Financing requirement	11.65	26
External Debt	Nil	Nil
Surplus cash internally borrowed	11.65	26

It should be noted that the Council has invested/borrowed internally. The surplus cash being relied upon comes from Council Tax and NNDR income received in advance of payments to precepting authorities and the Government, other timing differences between receipts from debtors and payments to creditors, grants, subsidies and contributions such as CIL, received in advance of spend.

The main advantages of this strategy are a lower exposure to external debt, and at the same time, lower exposure to counterparty risk in external investments.

However, no strategy is entirely risk free. The main risk of using cash surpluses generated as described above is that some will be available only temporarily. When the cash is required for its original purposes the authority may need to borrow externally to fund its capital spending plans at a time when interest rates are higher or other conditions are not favourable.

The Council has reserves which can be considered as cash backed and can be invested for longer periods as the Council always maintain a certain level of reserves and working capital. It is not unusual for Councils to hold investments equal to working capital whilst external debt is being used to fund capital expenditure.

There can be an opportunity cost on internal borrowing which is the interest we could have earned externally (the margin between external borrowing costs and investment income). On most occasions the interest rates on borrowing are higher than those earned on investments made by the Council. However, if long term borrowing rates are expected to rise, then it may be favourable to borrow to lock into favourable funding, the cash can be held as investments until utilised to pay for expenditure.

The Director of Financial Services undertakes Treasury Management within the limits set by the Capital Strategy and has the flexibility to adjust the balance between borrowing and investments to meet changing circumstances. The current preferred option is to as far as possible, internalise all surplus funds. However, with historically low borrowing rates it may become prudent to lock into longer-term debt and increase investment balances, perhaps by using external managers.

3.4 The principles of how borrowing could be undertaken externally are discussed in Section 5 below.

4 Investment 2021/22

4.1 The Council's investment strategy will prioritise its investment objectives in the following order:

- Security of assets – investing in counterparties only where the risks of incurring a capital loss through default and the risks of late payment of principal and interest, are low
- Liquidity – Ensuring that the authority can access enough cash to meet its obligations with appropriate notice. It is recommended for 2021/22 a target of at least £15m of short notice funds is held. The definition of short notice will be less than 35 days.
- Yield – subject to the management of risks associated with security and liquidity of assets, the Council will seek to maximise the yield from its investment portfolio

This is a prudent approach in line with CIPFA and MHCLG guidance.

4.2 No changes to Investment counter party rules are proposed for 2021/22 compared to those in 2020/21. The Council takes advice from Arlingclose, the Council's Treasury Advisors in determining who are suitable counter parties to hold Council funds.

4.2 No fixed duration investments over 365 days are currently proposed for 2021/22. This can be reviewed during 2021/22 depending on cashflow and counterparty risk. It is recommended any investments beyond 365 days are at the discretion of the Director of Financial Services.

4.3 The Council use Credit Ratings and Arlingclose's recommendations to determine suitable Counter Parties. Arlingclose's approach is not based on a rigid model but on an assessment of a range of measures that require a final human judgement of the overall risk. The assessments include the following; credit ratings, the likelihood of UK or another Government support, market information (e.g. share price or Credit Default Swap), collateral offered by the Counter Party, types of activity undertaken by the institution and other external advice. The Counter Parties recommended in this report reflect discussions by officers with Arlingclose, the Cabinet Member for Fairer Chelmsford and the Treasury Management and Investment Sub-committee.
No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.
Given the advice received by the Council regarding credit risks, sub inflation returns and potential economic slowdown the Council will retain within the strategy the following investments types:

- Enhanced Money Market Funds & Money Market Funds (MMF)
- UK Public bodies
- Unsecured Bank Investments
- Unsecured Building Society Investments
- Unsecured Non-UK Banks Investments
- Unsecured Registered Social Landlord Loans
- Covered Bonds, Reverse Repurchase Agreements and Supranational Bonds
- Potential to undertake unsecured Challenger bank investments
- Multi asset funds Bond and property funds

4.4 **Enhanced Money Market and Money Market Funds.** The Council has access to enhanced money market funds (AAA rated) which offer a rate of return (0.0-0.1%) but require 2 – 5 days' notice to withdraw funds.
The Council invests short-term cash in several AAA-rated money market funds. These funds provide a modest rate of interest around 0.01% at November 2020 and most importantly allow same day access to funds. These funds spread the Council's investment over many financial institutions, so reducing risk. Historically the funds have proved very safe.

4.5 **UK Public Bodies.** Debt Management Agency Deposit Facility, Government Treasury Bills or Gilts as these are all investments with the UK Central Government. These are the safest possible form of UK investment, so the Council will place no limit on the amount that can be invested.
Local Authorities / Bank Deposits Collateralised (guaranteed against local authority loans). These are theoretically as safe as lending to Government, but what would happen should a Local Authority go bankrupt has never been tested in law. It is therefore prudent to place some limit on investments with each local authority but recognising this type of investment is much safer than most alternatives. Arlingclose offer some guidance on risks of each local authority but the data is based on snap-shot year end accounts as only a few authorities can afford the cost of ratings by credit agencies.

4.6 **Unsecured UK bank investments.** The changes to UK Bank regulation from the adoption of a "bail-in" approach to recapitalising banks and the move to ringfencing of UK bank retail operations has increased the amount that could be lost in the event of a bank failure. With the completion of ringfencing activities by major banks to protect retail investors from investment banking losses, different banks have placed local authority depositors in either the retail or investment banking divisions. It should be noted that the credit scores for the banks with which the Council operates have either remained the same or improved as a result of ringfencing. The Council believes that it is still prudent to invest with banks subject first to credit rating criteria but considering the advice supplied by Arlingclose.

4.7 **Unsecured building society investments.** The Council's treasury strategy takes a different, more cautious approach to building societies than that recommended by Arlingclose, who undertake their own analysis to identify building societies that they believe have good financial characteristics. The Council instead requires that building societies have a long-term credit rating of at least A-.

4.8 **Unsecured Non-UK bank investments.** Arlingclose review the approach to investment with non-UK banks separately to UK banks. This reflects the different risks and ownership structures that affect the security of the investment. The Council first uses credit rating information to select appropriate non-UK banks and then uses Arlingclose advice to make investment decisions. The Council uses credit rating of AA- for selecting investments with non-UK banks of up to 364 days but over 100 days and A- for investments of up to 100 days.

4.9 **Registered Social Landlord (RSL) Loans.** The Council can lend to RSLs in the pursuit of treasury management objectives but must treat loans made for policy reasons as capital expenditure. The option to lend for Treasury purposes has been on the Council's counter party list for several years but there has not been a suitable opportunity.

4.10 **Covered Bonds, Reverse Repurchase Agreements and Supranational Bonds**. These are all different investment products but have the highest levels of credit rating. They are either backed by a pool of guaranteed bank assets or UK and/or foreign Governments. The Council takes advice from Arlingclose before undertaking any of these investments, so an investigation of the individual strength of each investment has been determined. They are rarely used by the Council.

4.11 **Multi-Asset, Bond and Property Funds**. These potentially offer the Council income and capital growth of the sum invested. There are several types of fund including property funds, bond funds, equity funds and mixed asset funds. Funds seek to reduce risk by building a pool of investments and as such are considerably safer than an investment of comparable size in a specific single asset. However, any fund exposes the Council to market price volatility. Officers will carefully consider any investment opportunities and always keep any ownership under review. A review of the risks

and benefits of using Funds was made in the summer of 2019 and which concluded that Multi-asset, Bond and Property funds provide a suitable method to invest Council funds.
At the time of drafting this report the Council has an investment of over £6m in the CCLA property fund and the Director of Financial Services is considering making investments in Multi-Asset and Bond funds, this decision is pending determination of the funding needs of the Council for its future capital programme.

4.12 **Challenger Banks.** As part of the Government's policy to reduce the size of banks and to encourage competition, new 'challenger banks' are appearing in the UK banking market. Many of these challenger banks are unrated but do have high levels of capital buffers. There has been insufficient evidence to demonstrate during 2020/21 that investments would be appropriately secure. However, it is recommended that the Treasury Management Sub-committee reviews any new evidence on these challenger banks and if satisfied that they provide sufficient Security, Liquidity and Return, that up to £3m could be invested by the Council.

4.13 **Counterparty – Duration and Monetary Limits**
The duration that an investment is made for impacts on the level of risk to capital invested. The longer the investment the more risk of some unexpected change occurring to the financial strength of the deposit taker. Perhaps, more importantly the Council can only invest for durations that enables Council liquidity to be managed effectively. To reduce these risks limits can be placed on the length of investments. The Council is required by law to identify the proposed investment criteria under the categories Specified and Non-Specified, as shown below:

Specified Investments -investments of duration less than 365 days and denominated in sterling. -investments made to UK Government, UK local authorities or institutions of high credit quality. - high credit quality defined as a minimum A- by Fitch or the equivalent score of the other main rating bodies.				
Specified Counterparty	Minimum Credit Criteria	Max. Limit £m	Max. maturity period	Change from Prev. approach
Enhanced Money Market Funds (Variable Unit Price) Up to 5 funds	AAA	£6m each fund	2-5-day notice	None
Money Market Funds (per fund)	AAA	£6m each fund	Instant Access	None
Debt Management Agency Deposit Facility, Government Treasury Bills or Gilts	UK Government	No Limit	364 days	None
Local Authorities / Bank Deposits Collateralised (guaranteed against local authority loans)	UK Government	£10m each authority	364 days	None

UK Banks	A-	£3m for each group	364 days	None
Building Societies	A-	£3m for each group	364 days	None
Non-UK Banks	AA-	£3m each group	364 days	None
Non-UK Banks	A-	£3m each group	100 days	None
Registered Social Landlord Loans	A-	£3m each group	364 days	None
Covered Bonds	AA-	£6m	364 days	None
Reverse Repurchase Agreements (each agreement)	AA-	£6m	364 days	None
Supranational Bonds (per institution)	AAA	£6m	364 days	None

A factor in setting the current individual limit of £3m per financial institution was it represented some 5% of total funds, clearly as investment balances fall the £3m represents a greater percentage of total funds, so investments become less spread proportionally if the £3m limit is kept. However, reducing the £3m limit would reduce the number of institutions willing to take Council deposits as the investment is judged too small to be economic for large institutions. The strategy must therefore balance these factors and for 2021/22 has retained the £3m limit.

Non-specified Investments

These do not meet the criteria of specified investments. They are identified separately to ensure the Council understands that these are higher risk, either due to counter party risk, liquidity risk, market risk or interest rate risk

Counterparty	Min. Credit Criteria	Max. Limit £m	Max. maturity period	Change from existing approach
CCLA Local Authority Property Fund	Unrated	£8m	n/a	None
Multi-Asset or Bond funds	Unrated	£5m per fund	n/a	None
Covered Bonds (per bond)	AA-	£6m	3 years	None

Supranational Bonds (per each institution)	AAA	£6m	3 years	None
Debt Management Agency Deposit Facility, Government Bills or Gilts	UK Government	No Limit	5 years	None
Local Authorities / Bank Deposits Collateralised (guaranteed against local authority loans)	UK Government	£10m each authority	5 years	None
Challenger Banks e.g. Aldermore, Metro etc	Unrated	Delegate to Treasury Management and Investment Sub-Committee authority to determine criteria to invest up to £3m		

5. Borrowing Sources

5.1 The Council has a need to fund its capital plans from borrowing. This section of the strategy sets out the Council's approach to borrowing. However, it is important to restate that borrowing is only used to fund the capital programme so the level of borrowing will never exceed the CFR for any meaningful amount of time. As previously stated, the CFR (Capital Financing Requirement) is the amount of capital expenditure the Council has financed by internal or external borrowing and so will be determined by the Budget Report 2021/22.

5.2 As stated in 3.3 the current assumption is internal borrowing is prioritised over externalising debt, however, the Director of Finance will monitor external rates of borrowing and the sustainability of using internal borrowing to determine if it becomes more beneficial to externalise the debt and invest core cash in deposits or investment funds.

5.3 When the Authority needs to borrow externally it will seek to strike a balance between minimising interest costs and securing certainty of borrowing costs. Examples of where the Council can seek to borrow funds from are:

- Public Works Loan Board (PWLB). This is only allowed if a Council has no approved plans to purchase properties primarily for the purposes of yield. More details can be found in the Investment Strategy and paragraph 5.4 below.
- Other UK Local Authorities. This is usually relatively short-term debt running from a few days to two years in duration.
- Any institution which meets the Council's investment criteria.
- UK public or private sector pension funds (Excluding the Essex Local Authority Pension Fund).

5.4 The PWLB can lend for up to 50 years and also for the short term to Local Government. The PWLB is the source of loans/funds if no other lender can provide finance. The Government after a period of consultation has announced that the PWLB will not lend to an authority that plans to buy investment assets primarily for yield that is identified in their capital programme. The Director of Financial Services will be expected by the PWLB to certify that no such purposes are planned. The CIPFA guidance by which Local Authority treasury management is assessed and governed is also likely to be altered to encourage further restriction of borrowing to fund investment purchases.

From a Treasury Management perspective it is recommended that the PWLB should be retained as a borrowing option and therefore the purchase of investment properties primarily for yield should be excluded from the capital programme. This is recommended not only due to the reduced rates now available through PWLB but due to the backstop accessibility of this source of borrowing.

5.5 The Council already has in place the following set of debt indicators and will revise them in the Capital Strategy:

- The Authorised Limit is the limit placed by the Council on the absolute level of its gross debt at any time. The Local Government Act 2003 stipulates that it must not be breached at any time.
- The Operational Boundary on the other hand is a lower figure reflecting the planned maximum level of debt at any time, the difference being designed to give headroom to deal with unforeseen movements in cash flow. It will not normally be a matter of concern if the Operational Boundary is breached temporarily due to variations in cash flow. However, a sustained or regular trend above the Operational Boundary would require investigation and appropriate action.

The authorised and operational borrowing will be set out in the Capital Strategy to be published in January 2021; they will be linked to the CFR (the borrowing needed to fund the capital programme).
Should the Council undertake long-term borrowing during 2021/22 then the Director of Finance will establish indicators to assist in the management of borrowing and these will be reported back to members.

5.6 Officers may decide to undertake very short-term borrowing for liquidity purposes.

5.7 In addition to borrowing via loans, other debt financing models may be used to finance the capital programme where this represents best value for the authority. These forms of debt are included in the overall borrowing limits. Such debt finance models include:

- Sale and leaseback arrangements
- Hire purchase arrangements

6. <u>Role of the Treasury Management and Investment Sub-committee</u>

6.1 The Sub-committee will be informed of investment activity and of significant changes in conditions that lessen or increase the risks of the Council’s Treasury Management activity. The Sub-committee will recommend changes to officers and where necessary report back to Council.

Investment Strategy

This document ensures compliance with the requirements of the CIPFA Prudential Code and Ministry of Housing, Communities and Local Government (MHCLG) guidance on local authority investment. The CIPFA code and MHCLG guidance recognise that organisations may make investments for reasons outside of treasury management objectives and these investments may prioritise other objectives above the security of capital.

Contents of the Investment Strategy

Identifies

- the types of Non-cash investments
- how Council monitors performance
- the role of the subcommittee

Service Investments: Loans and Shareholdings

These are investments, including making loans to and buying shares in local service providers, local small businesses to promote economic growth and for some authorities to subsidiary companies that provide services. In light of the public service objective, Councils can take moderate risk with the principal invested but still plan for such investments to return the sum invested.

The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Authority, upper limits on the outstanding loans have been set as follows

Category of borrower	31.3.2020 actual			2021/22
	Balance owing	Loss allowance	Net figure in accounts	Approved Limit
Chelmsford City Football Club	£0.125m	£0.122m	£0.003m	£0.122m
BID Company	£0.033m	Nil	£0.033m	£0.022m
Maximum New loans if required.	Nil	Nil	Nil	£10.000m
TOTAL LIMIT	**£0.158m**	**£0.122m**	**£0.036m**	**£10.144m**

The above table includes an allowance of up to £10m of new loans should the Council decide to create a standalone company for example to facilitate the creation of additional affordable housing or for other trading purposes. Any decision would be subject to Council approval.

Before entering and whilst holding loans or shares, the Council will monitor the financial position of the recipient through the use of (but not limited to) financial reporting tools, Credit ratings where appropriate, published financial information (such as annual accounts), press articles and by maintaining an open dialogue.

Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Governance: Service managers bid annually in September in the same way as for Capital Projects and Replacement Programme.

The bids are reviewed and prioritised by Management Team then referred to Cabinet which then makes recommendations to Council in February each year.

There are always going to be schemes which need to be approved outside this process, due to urgent health and safety issues for example, or the need to respond quickly to market opportunities and will need approval in line with financial rules.

Commercial Investments: Property

The Ministry of Housing Communities and Local Government defines property to be an investment if it is held primarily or partially to generate a profit. This type of investment may also involve making loans to subsidiaries or partners, but the aim is achieving profit.

The Council's commercial property investments are summarised below.

Property Type	31.3.2020 actual £ms					31.3.2021 expected £ms			
	Acquisitions	Disposals	Transfers*	Gains or (losses)	Value in accounts	Acquisitions	Disposals	Additional Gains or (losses)	Value in accounts
	In Year	In Year				In year	In Year	In Year	
Office	**£3.57**	**£0.00**	£0.00	-£0.13	£20.39	£0.00	£0.00	-£3.57	**£16.82**
Other	**£0.00**	**-£0.21**	-£0.65	-£0.48	£7.57	£0.00	£0.00	£0.00	**£7.57**
Retail	**£0.00**	**-£0.47**	£0.00	-£3.94	£51.29	£0.00	£0.00	-£10.26	**£41.03**
TOTAL	**£3.57**	**-£0.69**	-£0.65	-£4.55	£79.25	£0.00	-£0.19	-£13.83	**£65.23**

*The transfer of Baddow Rd shops to other Land and Buildings as it now considered as part of change to that part of the City.

Given the consequences of Covid19 it is felt appropriate to assume a 20% reduction in retail and 17% reduction in Office accommodation property assets will take place by 31 March 2021. Please note the values for 31/03/20 are from valuations included in the accounts and the external valuer placed a statement making clear there is material uncertainty over those valuations.

The Council can purchase commercial property for the partial or sole aim of generating profit. These commercial investments are a matter for the Council to decide as a policy and the previous policy included the limitation that purchases had to be within the Council's geographic borders. The principal risk of such investments includes:

- Investments funded from borrowing expose the Council to risk that the income generation from schemes is less than the cost of repaying the borrowing.
- Such investments must be proportionate to the size of the authority and do not concentrate risk in one particular sector or activity.
- Capital appreciation may not occur, and the value of the investment could fall in real terms.
- If future purchases are primarily for profit rather than for supporting service provision or regeneration, for example, this will prevent the Council from borrowing from PWLB for any purpose, under recently announced rules. This would increase the risks to cash liquidity and in the longer term increase the cost of Council financing.

The Council will continue to purchase commercial property but only where it supports regeneration, facilitates land assembly for future regen projects, supports Council priorities set out in "Our Chelmsford: Our Plan" but not where the primary purpose would be for yield.

Properties will only be purchased within the Council's geographic area or within the wider economic area (something that facilitates being able to buy on the borders if necessary)

Any properties purchased that generate commercial yield will be monitored by the sub-committee until redevelopment occurs.

Loan Commitments and Financial Guarantees

Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Authority and are included here for completeness. The Council has not committed to any such agreements.

Capacity, Skills and Culture

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Finance is a qualified accountant with 20 years' experience, the Head of Property is a member of the Royal Institution of Chartered Surveyors with over 20 years' experience in both Public and Private Sectors. The Council pays for junior staff to study towards relevant professional qualifications including CIPFA and external short courses in order to keep abreast of developments and maintain up to date skills and knowledge.

Elected members: The Council does not expect members to make investment decisions but to understand the risks the Treasury Strategy creates. The Council therefore provides training for members on the appropriate issues by providing advice and access to Arlingclose, the Council's Treasury Advisors.

Due Diligence

When undertaking investments there is a need to recognise where the Council is lacking detailed market knowledge and then external advisors will be employed. The Council uses Arlingclose as Treasury Management Advisors and external property valuers are engaged when undertaking material purchases.

Investment Indicators

The Authority has set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions.

Total risk exposure: The first indicator shows the Authority's total exposure to potential investment losses. This includes amounts the Authority is contractually committed to lend but have yet to be drawn down and guarantees the Authority has issued over third-party loans.

Total investment exposure	31.03.2020 Actual	31.03.2021 Forecast	31.03.2022 Forecast
Treasury management investments	£50.4m	£21m	£21m
Service investments: Loans	£0.158m	£0.144m	£10.144m
Commercial investments: Property	£79.25m	£65.23m	£65.23m
TOTAL INVESTMENTS	£129.808m	£86.374m	£86.374m

The changes in commercial property values are projected changes in assets values, which given the Covid pandemic are highly uncertain.

How investments are funded: Investments funded from borrowing have more risk than those funded from surplus resources, so the Government guidance is that there should be indicators on how investments are funded. Since the Authority does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing.

Investments funded by borrowing	31.03.2020 Actual	31.03.2021 Forecast	31.03.2022 Forecast	31.03.2023 Forecast
Service investments: Loans	Nil	Nil	Nil	Nil
Commercial investments: Property*	£3.5m	£3.5m	£4.2m	£4.2m
TOTAL FUNDED BY BORROWING	£3.5m	£3.5m	£4.2m	£4.2m

*The commercial property funded by debt in 2019/20 are a result of the Council decision to not make revenue contributions to capital in 2019/20. If the revenue contributions had been made the overall level of borrowing would have been lower and the commercial assets (Aquarium offices) would not have been funded from internal borrowing. The increase in borrowing in 2021/22 reflects an economic regeneration scheme at Galleywood Hall, this will be commercial units for rent aimed at increasing employment.

Rate of return received: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Investments net rate of return (income)	2019/20 Actual	2020/21 Forecast	2021/22 Forecast
Treasury management investments	1.25%	0.8%	0.8%
Service investments: Loans	Nil	Nil	Nil
Commercial investments: Property	6.7%	6.2%	5.9%
ALL INVESTMENTS Return	4.6%	4.1%	5.1%
Treasury Management Income £ms (draft estimate 21/22)	£0.8m	£0.3m	£0.3m
Investment Rent Income £ms (draft budget)	£5.3	£4m	£3.9m

The change in projected assets values result in higher rates of income return. The changes in rent income reflect falls in retail rent income, expected vacancies in an office block but are partially offset by a new source of income the Aquarium office purchase in the last part of 2019/20.

Other investment indicators

The Director of Finance has identified the following estimates to help assess Risks and Proportionality of investment activity at the Council:

Estimates	2020/21 estimate	2021/22 estimate	2022/23 estimate	2023/24 estimate
Income from Treasury Management as Percentage of Net Revenue Income	No longer to be measured less than 1% of budget			
Total Borrowing Undertaken to Fund Investment Properties	£3.5m	£3.5m	£4.2m	£4.2m
Commercial Income as percentage of Net Service Expenditure	9%	8%	9%	9%

The estimates/indicators reflect the historic decisions and the schemes included in the proposed/approved Capital programme. Below are limits on investments which reflect the estimates above plus allowance for some headroom or flexibility to undertake higher levels of investment activity. The limit is that recommended by the Director of Finance. These limits are required under Government guidance and should not be exceeded. If the Council does exceed these limits then it is expected not to rashly dispose of investments but instead should avoid entering into any further investments except for short term Treasury Management activity until appropriate alleviation of the breach is undertaken.

Limits	2020/21 Limit	2021/22 Limit	2022/23 Limits	2023/24 Limits
Commercial Income as percentage of Net Service Expenditure	16.9%	13%	13%	13%

Role of Treasury and Investment Sub-committee

The non-cash investments require continuous monitoring and the role of the sub-committee is to undertake that ongoing assessment. At a previous subcommittee meeting it was agreed that the following would be the basis of the ongoing monitoring:

- any changes in the portfolio in the period (acquisitions and sales)
- all charges and receipts, indicating any arrears.
- capital expenditure, planned or reactive.
- performance against budgets both expenditure and income.
- any potential changes to the income through lease renewals and rent reviews.
- any changes to Dunn and Bradstreet rating of tenants

The Sub-committee is also responsible for recommending the Investment Strategy. The strategy requires Full Council approval.