COUNCIL
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TITLE OF REPORT: INVESTMENT STRATEGY (INTEGRATED CAPITAL AND TREASURY)

REPORT OF : SERVICE DIRECTOR- RESOURCES
EXECUTIVE MEMBER : COUNCILLOR JULIAN CUNNINGHAM
COUNCIL PRIORITY : RESPONSIVE AND EFFICIENT

1. EXECUTIVE SUMMARY

1.1 The Council has produced an Investment Strategy in response to guidance from the Ministry for Housing, Communities and Local Government (MHCLG) and the Chartered Institute of Public Finance and Accountancy (CIPFA). It replaces the Capital Programme and Treasury Strategy that have previously been produced.

1.2 The Investment Strategy provides additional information that was not previously contained within the previous separate reports and this is explained in section 8.

1.3 The Investment Strategy contains the following key information:

- A capital programme for 2019/20 of £8.213m, and £11.303m for the period 2019/20 to 2023/24.
- Recommendations on Prudential Indicators and other Treasury Indicators that will be monitored and reported on during the year (2019/20)
- Changes to the scope of treasury investments to be included within the strategy.

2. RECOMMENDATIONS

2.1 That Cabinet recommend to Council the adoption of the Investment Strategy (as attached at Appendix A), including the capital programme and prudential indicators.

2.2 That Cabinet recommend to Council the adoption of the four clauses in relation to the Code of Practice on Treasury Management (as detailed in paragraphs 8.17 to 8.23).

3. REASONS FOR RECOMMENDATIONS

3.1 To ensure that the capital programme meets the Council's objectives and officers can plan the implementation of the approved schemes.

3.2 To ensure the Council's compliance with CIPFA's code of practice on Treasury Management, the Local Government Act 2003, statutory guidance from the Ministry of Housing, Communities and Local Government and the CIPFA Prudential Code. As well as determining and managing the Councils risk appetite in respect of investments.

4. ALTERNATIVE OPTIONS CONSIDERED

4.1 Each proposed capital scheme is the result of consideration of options for continuous service improvement by the relevant Service Director in consultation with the relevant Executive Member.

4.2 The primary principle governing the Council's investment criteria is the security and liquidity of its investments. After this the return (or yield) is then considered, which provides an income source for the Council. In general, greater returns can be achieved by taking on greater risk.

5. CONSULTATION WITH RELEVANT MEMBERS AND EXTERNAL ORGANISATIONS

5.1 All Members were given opportunity to comment on all new Capital investment proposals, as well as existing projects earmarked in future years, at the Member Budget Workshops held in November 2018. Notes of the comments and questions raised at the workshops were provided to Cabinet in December.

5.2 Members will be aware that consultation is incorporated into project plans of individual capital schemes as they are progressed.

5.3 There is ongoing dialogue with the Authority's Cash Manager, Tradition and regular meetings with Treasury advisors (Link).

6. FORWARD PLAN

6.1 This report contains a recommendation on a key decision that was first notified to the public in the Forward Plan on 18 December 2018.

7. BACKGROUND

7.1 On 2nd February 2018, the MHCLG published updated statutory guidance on Local Government investments. The guidance was effective from 1st April 2018, but it recognised that it had been published very late and therefore full implementation could be delayed until 2019/20. As at the date that the statutory guidance was issued, the Council's capital programme and treasury strategy has already been considered by Cabinet and recommended on to Full Council. Therefore the option was taken to defer to 2019/20.

7.2 Guidance issued by CIPFA is in the form of the Prudential Code (i.e. the Prudential Code for Capital Finance in Local Authorities, 2017 Edition) and the Treasury Management Code (i.e. the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, 2017 Edition).

7.3 The statutory guidance issued by the MHCLG has broadened the scope of what should be covered by the treasury management principles of Security, Liquidity and Yield. This has now been extended to include capital assets that are held for financial returns, rather than just treasury investments. For these assets it has also added a requirement to consider the fair value of the asset and the risk of loss.

7.4 The guidance also now requires a consideration of the full costs of holding assets, including both revenue and capital maintenance. It also encourages taking a longer term view of this expenditure i.e. up to 10 years.

7.5 The guidance provides a revised definition of 'borrowing in advance of need'. In the past this has been determined to be borrowing before it is strictly needed and then investing the surplus cash. If the borrowing is cheap enough and it is invested in the right way then this can create a net gain. The new definition now determines that borrowing for capital investments where they are acquired purely to generate profit is also now treated as borrowing in advance of need.

7.6 In the past, Members have approved a capital programme and a treasury management strategy. In line with the new guidance, these are now covered within a single Investment Strategy. Whilst there was an option to retain multiple documents, it was felt that this would have resulted in duplication and something that was less coherent.

7.7 The Finance, Audit and Risk Committee received an early draft of the Investment Strategy in September. This gave them an opportunity to comment on the format and readability of the document. The Shared Internal Audit Service (SIAS) have also audited the document to confirm that it adheres to the statutory guidance. The Council has agreed changes in relation to all the recommendations made.

7.8 The Corporate Business Planning Process begins each year with consideration of policy priorities and the Council's Priorities for the District and a review of the Medium Term Financial Strategy. Finance and other resources are aligned to the strategic priorities as set out in the Corporate Plan. This requires that each proposal for additional investment is linked to one of the three priorities identified in the Priorities document.

7.9 Cabinet receives quarterly updates on the delivery and funding of the Council's capital programme, with the report presented at the December meeting of Cabinet providing estimates as at the end of the second quarter of 2018/19. The report advised that total expenditure of £17.823m would be required to deliver the current capital programme for 2018-2023, with £7.211m forecast to be spent in 2018/19. Table 1 below details the changes to the existing capital programme reported to Cabinet since the Capital Programme was approved by Full Council in February 2018.

Table 1- Capital Estimates

	2018/19 £M	**2019/20 £M**	**2020/21 to 2022/23 £M**
Original Estimates approved by Full Council February 2018	**12.511**	**1.828**	**2.737**
Changes approved by Cabinet in 2017/18 Capital Outturn report (reprogramming from 2017/18)	5.644	0	0
Revised Capital Estimates at start of 2017/18	**18.155**	**1.828**	**2.737**
Changes approved by Cabinet at 1st Quarter	-2.298	0.150	-1.490
Addition to capital programme for lift at Town Hall / Museum	0.020	0	0
Changes approved by Cabinet at 2nd Quarter	-8.666	6.387	1.000
Current Capital Estimates	**7.211**	**8.365**	**2.247**

7.10 Members were given opportunity to comment on all new Capital investment proposals, as well as existing projects earmarked in future years, at the Member Budget Workshops held in November 2018. Notes of the comments and questions raised at the workshops were provided to Cabinet in December.

7.11 The Treasury Strategy Statement for 2018/19 was approved by Council in February 2018. A mid year review of the Treasury Strategy was provided to Council in January 2018. There have been no changes made to the Strategy during the course of 2018/19.

8. RELEVANT CONSIDERATIONS

8.1 The proposed Investment Strategy is attached at Appendix A. Council are asked to approve this strategy, which includes the following:

- New capital investment proposals totalling £0.391m
- A total capital programme for the period of 2019/20 to 2023/24 of £11.303m
- Adoption of a treasury strategy that covers borrowing and investment forecasts and limits, including prudential indicators

8.2 The following are provided as appendices to Investment Strategy, and are also appendices to this report:

- Appendix A1- A full list of planned future capital expenditure (2019/20 onwards)
- Appendix A2- A list of new capital schemes and schemes planned to commence from 2019/20

8.3 The format of the Investment Strategy is described in the introduction section (pages 2 and 3). A lot of the content of the Investment Strategy is combining information previously incorporated in the capital programme and treasury strategy. The following paragraphs detail the additional information required and any changes made to policies.

8.4 'Skills and Culture' section on pages 5 and 6. The new guidance requires the strategy to describe the training that has been put in place to enable decision makers to have the knowledge and information they need to make decisions. The increased scope of this strategy and the increased focus of the Council on commercial opportunities, increases the importance for training to be made available and for all decision makers to take it up.

8.5 In table 4 on page 10, the Council is now required to assess the security, liquidity and yield of the capital assets that are owned for purposes other than service delivery (i.e. to generate income). Security, liquidity and yield considerations have previously only been applied to treasury investments, and are not easy to apply to other types of asset. All of these income generating assets have been owned by the Council for many years and have provided a stable income stream. These concepts will be more relevant to the acquisition of any new assets. Similarly, table 5 on page 11 and 12 is a new requirement to consider the fair value of assets and the risk of loss. All the Council's investment assets are revalued annually on fair value basis (i.e. what an independent third party would pay for the asset). Due to the nature of most of the leases in place the risk of loss is very low.

8.6 In table 6 (pages 13) there is a new requirement to consider a 10-year time horizon in respect of the costs of maintaining assets in a useable condition. The values provided for years 6 to 10 are high level estimates only and will be subject to change. There is also is a new requirement to show the revenue costs of maintaining capital assets alongside the capital costs (page 13). Previously this would only have been reflected in the revenue budget. This helps to give a more complete picture in one place.

8.7 Tables 8 and 9 on page 15 are the equivalent of tables 4 and 5 (described above) for new planned capital assets. The only relevant assets are building or acquiring market housing. An overall summary is provided within the strategy, but the detail will depend on the exact assets and this analysis will form part of the business case for each one.

8.8 Table 10 provides estimates of the capital receipts that the Council estimates that it will receive from the disposal of surplus land and buildings. These are prudent estimates based on a view of the potential use for these sites. Actual values will be subject to planning and market conditions. Whilst the Council's Estates function has to fully operate within planning rules, it will do this with a commercial focus. The Council may choose to retain some of these sites for the purpose of generating revenue income. Any business case in relation to this would consider the lost capital income and the revenue implications (e.g. borrowing) of doing this.

8.9 Part 4 of the strategy (page 18 onwards) details the borrowing strategy of the Council. Given the estimates of capital spend and capital receipts, it is not expected that the Council will need to borrow any additional money. It will continue to hold existing borrowing due to the premiums attached to early repayment. The operational boundary (page 19) is the amount that external debt is not normally expected to exceed. Given that it is expected that the Council will not need to borrow any additional funds, this is set at £1m above the forecast of total external debt. The authorised limit is the limit beyond which external debt is prohibited without first reporting back to Full Council. This is set at around £5m above the operational boundary. This would cover the unlikely event that there is a need to borrow for cash-flow purposes.

8.10 Table 16 on page 26 details where the Council has provided, or plans to provide, loans that are not for treasury management purposes. The only example of an existing loan is to the Hertfordshire Building Control company, which is a jointly owned Local Authority company where the Council is also a shareholder. The potential future loan is to a wholly owned Property Company as a means to provide financing to the company. The table provides an assessment of the loan and the risks involved.

8.11 Part 5 of the strategy (page 25 onwards) sets out how the Council will invest its surplus cash, in terms of where and for how long. Surplus cash is generally made up of the General Fund balance, revenue reserves and provisions, s106 balances, capital receipts and set-aside receipts. Investment choices are based on applying the principles of security (how safe the underlying cash is), liquidity (how easy it is to access the cash) and yield (the interest earned), in that order.

8.12 No investment is completely safe and in general the yield earned is to compensate for the risk of holding that investment. The Council currently takes on greater risk than is recommended by our treasury advisors (Link Asset Services) in relation to:

- Investments in unrated UK Building Societies- this risk is partly managed by reviewing other available information and limiting the size of investments. It also reflects that Building societies are regulated to the same standards as UK banks and are prevented by law from undertaking risky financial trading. Furthermore, in the past when a building society has encountered difficulties, a merger with a stronger society has ensured that both wholesale depositors and retail savers experienced no interruption to service. There is of course no guarantee that this would continue to happen.
- Only investing within the United Kingdom- this limits the opportunities to diversify the portfolio of investments. Diversification allows risk to be spread across a number of different institutions and/or institutions with different risk exposures.

8.13 The previous investment strategy set limits based on the percentage of total available cash on the day that the investment is placed. This has resulted in two minor breaches of the strategy due to errors keeping track of the limit on that day (which have been reported to Cabinet). It also means that a long-term investment (e.g. 1 year) could be made on one day but not on the following day (or vice versa), even though the risk exposure is fundamentally the same.

8.14 To address the issues highlighted in 8.12, the following changes are included in the new strategy:

- To continue to invest in unrated UK building societies, but to reduce the amount that can be invested in each one and also make use of KPMG reports (already being used but are in addition to the current strategy). To also reduce the maximum amount that can be invested in Building Societies and Property funds combined to 60% (previously 75%).
- To allow investments in non-UK banks subject to both a country credit rating (as provided by Fitch) of AAA and above and an institution rating of AA- and above. These are both more stringent than are applied to UK investments (UK sovereign rating is currently AA and the minimum UK institution rating is BBB or above). Any investment would be in Sterling and therefore there would be no currency risk. The sovereign (country) limit has been deliberately set at the highest possible level, and is above the minimum level recommended by Link of AA-. As an example, this limit would not have allowed an investment in Iceland at any point preceding the crash in 2008. During the period from 2000 to 2008 the highest foreign currency rating was AA-. As at 28th December 2018, the following counties have a rating of AAA: Australia (4), Canada (5), Denmark (0), Germany (3), Netherlands (2), Singapore (3), Sweden (3), Switzerland (1) and USA (4). The numbers in brackets following each country is the number of institutions that meet the AA- institution rating criteria.

- To allow investments in any AAA rated Money Market Fund (MMF), not just UK only. The main point of MMFs is that they enable diversification, which is best achieved if the only limitation is the quality of the investments that they can invest in. It also widens the number of MMFs that the Council could invest in (currently only one meets the UK criteria), which allows diversification across MMFs. The MMF that the Council can currently invest in is only open to Local Authorities. This could be a liquidity risk if all the Councils wanted to disinvest at the same time.

8.15 To address the issue raised in 8.13 the new strategy takes the expected year end cash balance (as at 31st March 2020), based on budget and cash-flow forecasts. Any percentages will be applied to this total to convert it in to a £ value (rounded up to the nearest £1m) that will then be applied all year. For example, if it is expected that the year end cash balance will be £28m and 10% can be invested in any individual bank, then the limit will be £3m throughout the year.

8.16 The other changes that are included in the new strategy are:

- The current policy is unclear on whether there is a limit on UK Government Debt Management Office (DMO) investments. This is a short-term investment direct with the UK Government so is the safest place for the Council to put its cash. Therefore the proposal is that there is no limit on these investments.
- The current policy is unclear on whether there is a limit on other Local Authority investments in total. This is the next safest type of investment as it is with a tax raising body. Therefore the proposal is that there is no limit on these investments in total, but limited by the amount with any individual Local Authority.
- The current policy states that the balance in the Council's current account is excluded from any limits. The proposal is that a limit of £5m is set. This is an amount that is considered to be sufficient for cash management purposes and ensures that there is a formal control in relation to this.
- Any investments with a term of greater of 2 years will be subject to approval by the Chief Finance Officer, which will include a consideration of how much the investment will be as a percentage of total funds at the date it matures. It will be ensured that this is less than 40% of the estimated balance.

8.17 The Code of Practice on Treasury Management requires that a report be submitted to Full Council setting out four clauses which should be formally passed in order to approve adoption of the code. The four clauses are detailed below, including how they are met by the Council. As recommended by CIPFA, where appropriate these are included within the Council's Constitution and Financial Regulations.

8.18 Clause 1 relates to creating and maintaining a Policy and practices as a cornerstone for effective treasury management.

8.19 Full Council are asked to approve the adoption of the following Treasury Management Policy Statement, which is the same as in previous years:

- *This organisation defines its treasury management activities as: "The management of the authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".*
- *This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.*
- *This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.*

8.20 The Council has adopted treasury management practices (TMPs) which set out how the Council will carry out, manage and control the achievement of the policy above in practice. These TMPs are substantially unchanged from last year and follow the recommendations contained within the Code, subject only to amendment where necessary to reflect the particular circumstances of the Council. Such amendments are minor and do not result in any material deviation from the Code's key principles. The TMPs are operationally focused and therefore the themes covered are detailed below, rather than providing the full document. Where relevant the detail is already covered in the Investment Strategy (e.g. approved instruments):

- TMP1- Risk Management
- TMP2- Performance Measurement
- TMP3- Decision making and analysis
- TMP4- Approved instruments, methods and techniques
- TMP5- Organisation, clarity and segregation of responsibilities, and dealing arrangements
- TMP6- Reporting requirements and management information arrangements
- TMP7- Budgeting accounting and audit arrangements
- TMP8- Cash and cash-flow management
- TMP9- Money laundering
- TMP10- Staff training and qualifications
- TMP11- Use of external service providers
- TMP12- Corporate Governance

8.21 Clause 2 relates to the reporting on treasury activities. These are set out in the Investment Strategy on page 3.

8.22 Clause 3 relates to the delegation of responsibility for the implementation and regular monitoring of its treasury management policies. The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet (Constitution 5.6.9) and for the execution and administration of treasury management decisions to the Service Director: Resources (Constitution 14.6.12 (a) (iii) and Financial Regulations section 13) who will act in accordance with the Council's policy statement and treasury management practices and the CIPFA Standard of Professional Practice on Treasury Management.

8.23 Clause 4 relates to the scrutiny of treasury management strategy and policies. The Council nominates the Finance, Audit and Risk Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies (Constitution 10.1.5 (c)).

9. LEGAL IMPLICATIONS

9.1 Full Council will decide the overall capital budget (Constitution 4.3) and approve the treasury management strategy statement (Constitution 4.4.1 (dd)).

9.2 Cabinet will recommend to Full Council the annual capital budget (Constitution 5.6.38) and treasury management strategy statement (Constitution 5.6.39).

9.3 The Finance, Audit and Risk Committee will consider the Council's policy in relation to Treasury Management and make recommendations on the Annual Treasury Management and Investment Strategy, and Treasury Management Code of Practice (Constitution 10.1.5 (c)).

9.4 Section 151 of the Local Government Act 1972 states that: "every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs." That officer is the Service Director- Resources.

9.5 The proposed Prudential Indicators contained within the Investment Strategy comply with the Local Government Act 2003. The Investment Strategy has been developed to comply with the statutory guidance from the Ministry of Housing, Communities and Local Government and the CIPFA Prudential Code.

10. FINANCIAL IMPLICATIONS

10.1 The financial implications are covered in section 8 of the report.

11. RISK IMPLICATIONS

11.1 Capital investment is sometimes needed to mitigate against a risk to the Council. This is detailed to Members when a new investment comes forward. The risk implications of each individual scheme are considered in project plans as the schemes are progressed. The capital programme assumes a level of third party contributions and grants towards the cost of the schemes. There is a risk that not all the contributions are forthcoming.

11.2 Investment risks in relation to treasury management are covered in this report and the Investment Strategy. The TMPs (see 8.20) and Financial Regulations provide controls to manage other risks.

12. EQUALITIES IMPLICATIONS

12.1 In line with the Public Sector Equality Duty, public bodies must, in the exercise of their functions, give due regard to the need to eliminate discrimination, harassment, victimisation, to advance equality of opportunity and foster good relations between those who share a protected characteristic and those who do not.

12.2 There are no direct equalities implications directly arising from the adoption of the Capital Programme for 2018/19 onwards. For any individual new capital investment proposal of £50k or more, or affecting more than two wards, an equality analysis is required to be carried out. This will take place following agreement of the investment proposal.

13. SOCIAL VALUE IMPLICATIONS

13.1 The Social Value Act and “go local” policy do not apply to this report.

14. HUMAN RESOURCE IMPLICATIONS

14.1 There are no direct human resources implications.

15. APPENDICES

15.1 Appendix A: Investment Strategy (Integrated Capital and Treasury)

15.2 Appendix A1- A full list of planned future capital expenditure (2019/20 onwards)

15.3 Appendix A2- A list of new capital schemes and schemes planned to commence from 2019/20

16. CONTACT OFFICERS

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