SPECIAL POLICY AND RESOURCES SCRUTINY COMMITTEE – 24TH SEPTEMBER 2014

SUBJECT: INVESTMENT STRATEGY

REPORT BY: ACTING DIRECTOR OF CORPORATE SERVICES AND SECTION 151 OFFICER

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1. PURPOSE OF REPORT

1.1 This report sets out a range of options for Members to consider in relation to the Council's investment strategy.

1.2 The options presented in the report have the potential to increase investment income, which will support the Medium-Term Financial Plan (MTFP).

2. SUMMARY

2.1 The Council currently deposits surplus cash balances with the Debt Management Office (DMO) and other local authorities (including police and fire authorities) for periods up to three months. In line with the Council's approved Treasury Management Strategy (TM Strategy) there is no restriction in terms of the value of investments that can be placed with the DMO but only £5m can be deposited with a local authority. Furthermore, the Council can only place deposits for a maximum period of 3 months with each counterparty.

2.2 The TM Strategy is reviewed annually and is approved by full Council as part of the budget setting process. Historically the Council has deposited funds with national and international banks and building societies, but since the financial crisis of 2008 the Council had reverted to a risk adverse strategy.

2.3 This report presents options for Members to consider in relation to the current approach to investments. A number of models are presented, which have been prepared by the Council's treasury management advisors, Arlingclose.

3. LINKS TO STRATEGY

3.1 Treasury Management Strategy 2014/2015 as agreed by Council on the 26th February 2014.

4. THE REPORT

4.1 Financial markets are now stabilising and progress is being made on the economic recovery. As a result the Council has an opportunity to review its investment strategy and risk appetite.

4.2 Although the Bank of England Base Rate has remained at 0.50% since 2009, the DMO currently pays a flat rate of 0.25%. Local authorities on the other hand pay between 0.26% and 0.30%, a somewhat minor improvement over the DMO. As at the 31st March 2014, the Council generated an average rate of return of 0.27% for average balances of £85.6m. This equated to circa £230k of interest. The Council has one of the lowest risk and return profiles when compared to other local authorities as benchmarked by Arlingclose. In the current environment, other local authorities have earned average returns on their investments of between 0.50% and 0.75%.

4.3 In March 2014 a report was presented to the P&R Scrutiny Committee seeking Members views on fine-tuning the Council's risk appetite to enhance investment income. After considering the report the Scrutiny Committee requested that the Council's Treasury Advisors, Arlingclose, should be invited to present further details on the investment options available to the Council. This was subsequently arranged as a Members' Seminar on the 15th July 2015.

4.4 At the Members' Seminar Arlingclose presented details of an alternative investment portfolio, which had the potential to increase investment income to £554k, as detailed in Appendix 1. This revised portfolio assumes an average investment of £74.8m spread across a mixture of 20 investment instruments with an average balance of £3.74m yielding a return of 0.74%. The return has more that doubled, but average investment duration has gone from 21 days to 281 days, whilst risk has increased marginally. Risk has been measured on two factors; duration and size of investment needed to generate sizeable returns. Both risk factors have increased when compared to existing investment practices.

4.5 The revised portfolio would hold instruments such as gilts, fixed term deposits (DMO and LA), call account super-national bonds and money market funds. These instruments are currently covered by the TM Strategy. However, the proposed portfolio also includes a AAA credit rated instrument called covered bond, which is not currently permitted by the TM Strategy. Council would, therefore, need to approve an amendment to the TM Strategy to allow for the inclusion of covered bonds. Furthermore, the TM Strategy only permits non-specified investment (investments held longer than 1yr) to a limit of £10m. This will also need to be changed to accommodate the long-term investments as proposed under the revised portfolio.

4.6 The revised portfolio has £15m invested for up to 2.5 years and £13m invested for 1 year. The Council will have £12m of cash available within 1 day with the remainder (£34.8m) being available within 9 months. This would suit the Council's cash flow profiling.

4.7 At the request of Members, Arlingclose have now prepared further options for consideration as set out in Appendix 2. These scenarios are based on investment returns of £1m (Model 1), £500k (Model 2) and £655k (Model 3). The models are based on the same investment portfolio value of £74.8m, with an average investment size of £3.5m and 21 investments (average across the three portfolios). Whilst all three portfolios essentially use the same instruments as per the portfolio detailed in Appendix 1, higher returns are generated by investing longer.

4.8 Model 1 has an average investment duration of 3 years, with a return of 1.36% (£1.02m). £20.3m is available within a day's notice, £8.5m is invested for 1 year, whilst £46m is invested for longer than 1 year. This portfolio would represent liquidity risk as there is not enough cash available to cover the short-term period (3 months to 1 year). Officers do not, therefore, recommend this option. The use of corporate bonds and floating rate notes (in addition to the covered bond) will require an amendment to the TM Strategy.

4.9 Model 2 is similar to the scenario in Appendix 1 and has an average duration of 188 days and yields a return of 0.67% (£500k). £17m is available within a day's notice, £21.8m within 2 months and £9m is invested longer than 1 year. The remaining £27m is invested between 3 and 12 months. This portfolio would suit the Council's cashflow profiling. An amendment to the TM Strategy would be required for the use of covered bonds and the duration of some of the proposed investments.

4.10 Model 3 has an average duration of 421 days and yields a return of 0.88% (£655k). £16.8m is available within a day's notice, £5m within 2 months and £24m is invested longer than 1 year (with £2m at 5yrs with a local authority). The remaining £29m is invested between 3 and 12 months. This portfolio would also suit the Council's cashflow profiling. The use of corporate bonds (in addition to covered bonds) will require an amendment to the TM Strategy.

4.11 All scenarios presented in this report have increased risk in the form of investing for longer periods and for larger amounts. The credit quality of counterparties has been maintained in accordance with the TM strategy, the lowest being rated A. The emphasis on generating higher returns is to invest large balances for a long period of time. The risks with each scenario are still respectively lower than for other benchmarked UK local authorities.

5. EQUALITIES IMPLICATIONS

5.1 There are no equalities implications arising from this report.

6. FINANCIAL IMPLICATIONS

6.1 As identified throughout the report.

7. PERSONNEL IMPLICATIONS

7.1 There are no direct personnel implications arising from this report.

8. CONSULTATIONS

8.1 There are no consultation responses that have not been reflected in this report.

9. RECOMMENDATIONS

9.1 Members of the Scrutiny Committee are asked to consider and comment upon the content of this report.

10. REASONS FOR THE RECOMMENDATIONS

10.1 To ensure that the views of the Scrutiny Committee are considered prior to proposals being presented to Cabinet/Council.

11. STATUTORY POWER

11.1 Local Government Acts 1972 and 2000.

Author: Nadeem Akhtar – Group Accountant (Financial Advice and Support)
E-mail: akhtan@caerphilly.gov.uk Tel: 01443 863313
Consultees: Nicole Scammell, Acting Director of Corporate Services & S151 Officer
Stephen Harris, Interim Head of Corporate Finance
Cllr Barbara Jones, Deputy Leader & Cabinet Member for Corporate Services

Appendices:
Appendix 1 Investment Scenario Presented At Members Seminar (15th July 2014)
Appendix 2 Further Models for Consideration