Report No.
FSD14057

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**Executive**
	10th September 2014
	Council
	29th September 2014
	For Pre-Decision Scrutiny by the Executive and Resources PDS Committee on:
Date:	**3rd September 2014**
Decision Type:	Non-Urgent Executive Non-Key
Title:	**TREASURY MANAGEMENT - INVESTMENT STRATEGY REVIEW & Q1 PERFORMANCE 2014/15**
Contact Officer:	Martin Reeves, Principal Accountant (Technical & Control) Tel: 020 8313 4291 E-mail: martin.reeves@bromley.gov.uk
Chief Officer:	Director of Finance
Ward:	Alll

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1. Reason for report

1.1 This report summarises treasury management activity during the June quarter and includes recommended changes to the Council's Treasury Management Investment Strategy, which would require the approval of full Council. The report also includes an update on the Council's investment with Heritable Bank (paragraphs 3.21 and 3.22). Investments as at 30th June 2014 totalled £287.2m (excluding the balance of the Heritable investment) and there was no outstanding external borrowing. For information and comparison, the balance of investments stood at £247.4m as at 31st March 2014 and £259.1m as at 30th June 2013.

RECOMMENDATION(S)

The Executive is requested to:

(a) Note the actual Treasury Management performance in the quarter ended 30th June 2014; and

(b) Recommend to Council the following changes to the Council's Treasury Management Investment Strategy:

- **An increase in the total investment limit for the two part-nationalised banks, Lloyds and Royal Bank of Scotland, to £80m each and in the maximum investment period to 3 years (see paragraphs 3.27 to 3.29); and**

- **A reduction in the minimum credit rating for corporate bond investments to A- (see paragraphs 3.30 to 3.34).**

- **Approval to invest up to £10m in Diversified Growth Funds (see paragraphs 3.35 to 3.37).**

Council is requested to approve the following changes to the Council's Treasury Management Investment Strategy:

- **An increase in the total investment limit for the two part-nationalised banks, Lloyds and Royal Bank of Scotland, to £80m each and in the maximum investment period to 3 years (see paragraphs 3.27 to 3.29); and**

- **A reduction in the minimum credit rating for corporate bond investments to A- (see paragraphs 3.30 to 3.34).**

- **The addition of Diversified Growth Funds as permitted investments, with a total investment of up to £10m (see paragraphs 3.35 to 3.37).**

Corporate Policy

1. Policy Status: Existing policy. To maintain appropriate levels of risk, particularly security and liquidity, whilst seeking to achieve the highest rate of return on investments.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: N/A

2. Ongoing costs: N/A.

3. Budget head/performance centre: Interest on balances

4. Total current budget for this head: £1.591m (net) in 2014/15; interest earnings estimated to be on target at this stage

5. Source of funding: Net investment income

Staff

1. Number of staff (current and additional): 0.25 fte

2. If from existing staff resources, number of staff hours: 9 hours per week

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Legal

1. Legal Requirement: Non-statutory - Government guidance.

2. Call-in: Call-in is applicable for Executive Decision

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): n/a

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Ward Councillor Views

1. Have Ward Councillors been asked for comments? N/A.

2. Summary of Ward Councillors comments:

3. COMMENTARY

General

3.1 Under the requirements of the CIPFA Code of Practice on Treasury Management, the Council is required, as a minimum, to approve an annual treasury strategy in advance of the year, a mid-year review report and an annual report following the year comparing actual activity to the strategy. In practice, the Director of Finance has reported quarterly on treasury management activity for many years, as well as reporting the annual strategy before the year and the annual report after the year-end. This report includes details of investment performance in the first quarter of 2014/15 and proposes changes to the investment criteria that form part of the Council's Annual Investment Strategy, which seek to provide a wider range of investment options. The annual report for the whole of the financial year 2013/14 was submitted to the Executive & Resources PDS Committee on 5th June and to the Council meeting on 21st July.

3.2 Recent changes in the regulatory environment place a much greater onus on members for the review and scrutiny of treasury management policy and activities. This report is important in that respect, as it provides details of the actual position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

3.3 The Council has monies available for Treasury Management investment for the following main reasons:

(a) Positive cash flow;
(b) Monies owed to creditors exceed monies owed by debtors;
(c) Receipts (mainly from Government) received in advance of payments being made;
(d) Capital receipts not yet utilised;
(e) Provisions made in the accounts for liabilities e.g. provision for outstanding legal cases which have not yet materialised;
(f) General and earmarked reserves retained by the Council.

3.4 Some of the monies identified above are of short term use and cannot be used for longer term investment purposes and any investment of these needs to be highly "liquid", particularly if it relates to a positive cash flow position which can change in the future. The future monies available for Treasury Management investment will depend on the budget position of the Council and whether the Council will need to substantially exhaust capital receipts and reserves. Against a backdrop of unprecedented cuts in Government funding (which will require the Council to make revenue savings to balance the budget in future years), there is a probability that such actions may be required in the medium term which will reduce the monies available for investment.

3.5 The Council has approved an Investment Strategy for Treasury Management, which has been regularly reviewed over the last two years to provide a wider range of investment options, ranging from investment in corporate bonds to various investment choices over a 3 to 5 year timeframe including a £10m investment made in a property fund. Further changes being proposed in this report include using a lower credit rating for investments (but still maintaining "investment grade" ratings), widening the range of investments available with a minimal increase in risk. In addition, revisiting the option to increase lending limits to part-nationalised banks and investing in a Diversified Growth Fund. The Treasury Management Code of Practice sets out that priority is given to security and liquidity over the return on investments. Any "wholesale" investment made by the Council does not have the protection available to personal savers.

3.6 The Council has also identified an alternative investment strategy relating to property investment. Further details are provided elsewhere on this agenda and the planned property purchases, including purchases to date, will generate income of £2m per annum with an

equivalent yield of 5 to 6%. This is based on a longer term investment timeframe of at least 3 to 5 years. This alternative investment ensures that the monies available can attract higher yields for the longer term. The report elsewhere on this agenda seeks to increase the level of investment in property.

3.7 A combination of lower risk investment relating to Treasury Management and a separate investment strategy in property acquisitions generating higher yields (and risks) provides a balanced investment strategy. Any investment decisions will also need to consider the high probability that interest rates will increase. The available resources for the medium term, given the ongoing reductions in Government funding, will need to be regularly reviewed.

Treasury Performance in the quarter and year ended 30th June 2014

3.8 **Borrowing:** The Council's healthy cashflow position continued through the whole of 2013/14 and through the first quarter of 2014/15, as a result of which no borrowing has been required.

3.9 **Investments:** The following table sets out details of investment activity during the June quarter:-

	£m	%
Balance of "core" investments b/f	172.00	0.83
New investments made in period	76.00	0.95
Investments redeemed in period	-48.50	0.61
"Core" investments at end of period	199.50	0.95
Money Market Funds	32.70	para 3.17
RBS 95 day notice account	15.00	para 3.18
Svenska Handelsbanken instant access	15.00	para 3.18
Deutsche Bank 95 day notice	5.00	para 3.18
CCLA Property Fund	5.00	para 3.20
Payden Sterling Reserve Fund	15.00	para 3.19
Total investments at end of period	**287.20**	**n/a**

3.10 Details of the outstanding investments at 30th June 2014 are shown in maturity date order in Appendix 1 and by individual counterparty in Appendix 2. The average return on all new "core" investments during the June quarter was 0.95%. For comparison, the average LIBID rates for the June quarter were 0.34% for 7 days, 0.41% for 3 months, 0.52% for 6 months and 0.82% for 1 year.

3.11 Base rate has now been 0.5% since March 2009 and, although the estimated date for the next increase in base rate has slipped back significantly in the last two to three years (most recently to the end of 2015), the latest forecast by Sector (in August 2014) is for it to begin to slowly rise from early in 2015. Reports to previous meetings, most recently to the February meeting, have highlighted the fact that options with regard to the reinvestment of maturing deposits have become seriously limited due to bank credit rating downgrades. Changes to lending limits and eligibility criteria have in the past been temporarily successful in alleviating this, but we are now back in the position of not having many investment options other than placing money with instant access accounts at relatively low interest rates. Active UK banks on our list now comprise only Lloyds, RBS, HSBC, Barclays, Santander UK and Nationwide and all of these have reduced their interest rates significantly.

3.12 Our external advisers, Sector, continue to recommend caution and, between September 2011 and January 2013, were recommending that no investment be placed for longer than 3 months with any bank other than Lloyds and RBS (a maximum of 1 year was recommended in their case). In January 2013, however, they lifted their temporary investment duration cap and, since then, we have been able to invest with some of our eligible UK counterparties for up to 6 months instead of 3, which will have had a small beneficial impact on interest earnings. In 2014/15 (mainly in Q2), we have also placed money on deposit for two years (the maximum permitted by our approved strategy) with both Lloyds and RBS and have placed a number of deposits for

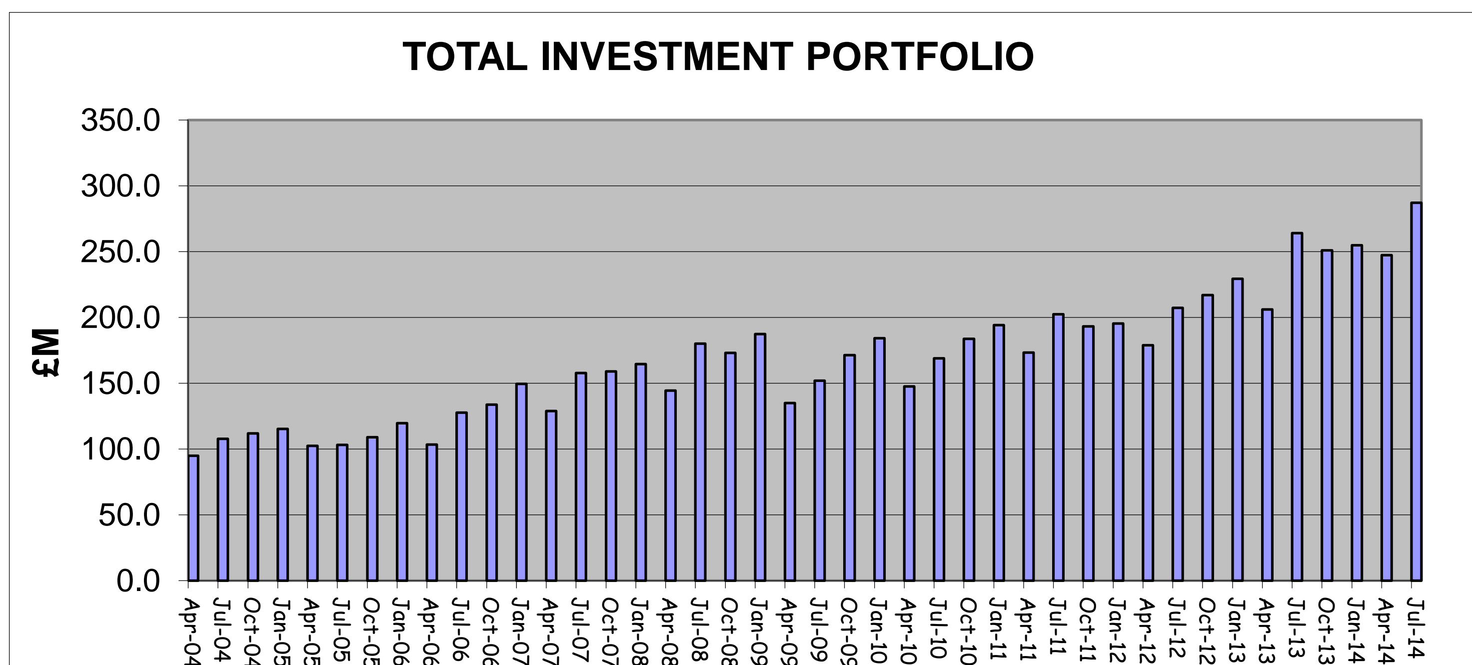
three years with other local authorities. Those investments that were placed before 1st July 2014 are all included in Appendices 1 and 2.

3.13 In the June quarter, while we mainly placed short-term investments, we also invested £15m for 2 years with another local authority and £15m for 2 years with RBS (at 1.14% and a minimum of 1.15% respectively) and invested a total of £15m for 1 year in Standard Life and RBS certificates of deposit at an average of 0.825%. While these rates do not sound particularly attractive, they are better than we are currently able to obtain for the same periods elsewhere in the market and are, in the view of Sector and other experts, likely to prove good deals in the fullness of time.

3.14 Since the end of June, we have taken advantage of an increase in demand for cash from other local authorities and have invested a total of £23m at rates between 1.50% and 1.90%. We have also placed a total of £10m for 2 years with Lloyds at an average of 1.265% and a further £15m in a 2-year deposit with RBS linked to the 3-month Libor rate, but with a floor of 1.52% and a ceiling of 2.00%. Finally, we have invested a further £5m with the CCLA Property Fund, bringing the total up to £10m.

3.15 Lloyds has consistently offered better rates than other UK banks, but has reduced its rates significantly in the last year and is currently offering 0.70% for 3 months up to 0.95% for 1 year (they were paying 3.00% for 1 year as recently as July 2012) and 1.25% for 2 years. All the other UK banks and building societies on our lending list are now paying around 0.58% for 3 months and around 0.68% for 6 months, both of which have improved in recent months. The Director of Finance will continue to monitor rates and counterparty quality and take account of external advice prior to any investment decisions.

3.16 The graph below shows total investments at quarter-end dates back to 1st April 2004 and shows how available funds have increased steadily over the years, largely due to the earlier receipt of government funding. This has been a significant contributor to the over-achievement of investment income against budgeted income in recent years.



Other accounts

3.17 Money Market Funds

The Council currently has 7 AAA-rated Money Market Fund accounts, with Prime Rate, Ignis, Insight, Morgan Stanley, Blackrock, Fidelity and Legal & General, all of which have a maximum investment limit of £15m. In common with market rates for fixed-term investments, interest rates on money market funds have fallen considerably in recent years. The Ignis fund currently offers the best rate (around 0.45%). The total balance held in Money Market Funds (£32.7m as at 30th June 2014 and, currently, £37.0m as at 19th August 2014) has increased significantly in the past year as bank credit rating downgrades have continued to restrict counterparty eligibility. If and when other investment options become available, this balance will reduce, as Money Market Funds currently offer the lowest interest of all our eligible investment vehicles with the exception of the Government Debt Management and Deposit Fund (currently 0.25%). If Members agree to the proposals in this report, then the additional investments (mainly with part-nationalised banks) will be funded by reducing holdings with money market funds and other low interest accounts.

Money Market Fund	Date Account Opened	Ave. Rate 2013/14	Ave. Daily Balance 2013/14	Actual Balance 31/03/14	Actual Balance 30/06/14	Ave. Rate Q1 2014/15	Actual Balance 19/08/14	Current Rate 18/08/14
		%	£m	£m	£m	%	£m	%
Prime Rate	15/06/2009	0.42	12.7	-	2.7	0.40	-	0.42
Ignis	25/01/2010	0.43	14.7	15.0	15.0	0.44	15.0	0.45
Insight	03/07/2009	0.39	6.9	4.3	15.0	0.40	7.0	0.42
Morgan Stanley	01/11/2012	0.41	7.5	-	-	0.37	-	0.40
Legal & General	23/08/2012	0.34	2.2	-	-	0.37	15.0	0.43
Blackrock	16/09/2009	0.31	0.1	-	-	-	-	0.33
Fidelity	20/11/2002	n/a	-	-	-	-	-	0.36
TOTAL			44.1	19.3	32.7		37.0	

3.18 Notice Accounts

Svenska Handelsbanken

In August 2013, the Council placed £15m in an instant access account with the Swedish Bank, Svenska Handelsbanken. The account originally paid 0.60%, but the rate was reduced to 0.50% in July 2014. As investment options are limited and the rate is better than that we are earning on our Money Market Funds, the account has been left open and the £15m was still invested as at 18th August 2014. The average daily balance in the first quarter of 2014/15 was £3.75m.

RBS

In March 2013, RBS announced a new 95-day notice account paying a rate of 0.80%. The Council made an initial deposit of £12.5m in March and increased this to £15m in April 2013. The rate was reduced to 0.60% in October 2013 and, in April 2014, RBS informed us that the rate would reduce to 0.30% in August, so we have given notice to close the account with effect from 25th August 2014. The £15m was still invested as at 18th August 2014 and the average daily balance in the first quarter of 2014/15 was £3.75m.

Deutsche Bank

In the autumn of 2013, Sector notified the Council that they had negotiated a 95-day notice account facility with Deutsche Bank at a rate of 0.75%. Deutsche is an eligible counterparty on our lending list with a maximum investment sum of £5m and, on 25th November 2013, this sum

was deposited. The £5m was still invested as at 18th August 2014 and the average daily balance in the first quarter of 2014/15 was £1.25m.

3.19 Other investments: Corporate Bonds and Payden Sterling Reserve Fund

At its meeting on 12th November 2012, the Council approved the addition of corporate bonds (minimum credit rating AA-, maximum period 5 years) and the Payden Sterling Reserve Fund to our lending list. On 27th November, following advice from Sector, we made our first investment in a corporate bond, £1.1m with Standard Chartered Bank. The bond matured after the year end on 28th April 2014 with a coupon value of 0.70%. This report recommends a lowering of the minimum credit rating for corporate bonds to A- (see paragraphs 3.29 to 3.33), which may provide us with more investment opportunities in the future. In November 2012, £15m was invested in the Payden Fund and that sum was still invested as at 18th August 2014. The longer-term nature of the Payden Fund means that a better return will be secured by holding to maturity, although we could at any time withdraw our money by giving 3 days' notice. As at 30th June 2014, our share of the Payden Sterling Reserve Fund was valued at £15,180k, which represented a return of 0.74% since inception.

3.20 Investment in CCLA Property Fund

In September 2013, the Portfolio Holder and Full Council approved the inclusion of collective (pooled) investment schemes as eligible investment vehicles in the Council's Investment Strategy with an overall limit of £25m and a maximum duration of 5 years. Such investment would require the approval of the Director of Finance in consultation with the Resources Portfolio Holder. Following consultation between the Director of Finance and the Resources Portfolio Holder, an account was opened in January with the CCLA Local Authorities' Property Fund and an initial deposit of £5m was made. Following more consultation, a further £5m deposit was made at the end of July 2014. This is a medium to long-term investment and performance data will be reported in due course.

3.21 Investment with Heritable Bank

Members will be aware from regular updates to the Resources Portfolio Holder and the Executive that the Council had £5m invested with the Heritable Bank, a UK subsidiary of the Icelandic bank, Landsbanki, when it was placed in administration in early-October 2008 at which time our investment was, and still is, frozen. An initial dividend was paid to the Council in July 2009 and, since then, a further 13 dividends have been received. To date, 94.0% (£4,783k) of our total claim (£5,087k) has been returned to us, leaving a balance of £304k (6.0%). Council officers and our external advisers remain hopeful of a full recovery.

3.22 For information, the claim we were obliged to submit consisted of the principal sum (£5m) plus interest due to the date on which Heritable was placed in administration (around £87,000). We were not able to lodge a claim for the full amount of interest (£321,000) that would have been due at the original investment maturity date (29/6/09). In accordance with proper accounting practice and guidance from CIPFA, we made provision in our 2008/09 accounts for an impairment loss of £1.64m and met this from the General Fund in that year. In line with revised guidance from CIPFA relating to the 2009/10 accounts, we were able to reduce the impairment by £300k and this sum was credited to the General Fund. An improvement in the administrator's recovery estimate in 2011 to between 86% and 90% (previously it was between 79% and 85%) enabled us to reverse a further £730k of the impairment in 2011/12. The Council's accounts included a provision for a net loss of £610k as at 31st March 2013 (12% of the claim, based on the midpoint of the administrator's estimate), but, as we had recovered 94% as at 31st March 2014, we were able to reverse more of the impairment in 2013/14 (£311k). We are currently waiting for an update from the administrator.

3.23 External Cash Management

External cash managers, Tradition UK Ltd, currently manage £20m of our cash portfolio and provide useful advice and information on treasury management matters. In the first quarter of 2014/15, Tradition UK achieved a return of 1.08% (mainly as a result of two longer term investments placed with other local authorities in March 2014). Tradition UK work to the same counterparty list as the Council's in-house team and so have also been constrained by strategy changes approved after the Icelandic Bank crisis and by ratings downgrades in recent years. Details of externally managed funds placed on deposit as at the time of writing this report are shown below.

Bank	Sum	Start Date	Maturity	Period	Rate
HSBC	£5m	26/06/14	26/08/14	3 months	0.65%
Lloyds	£7.5m	18/08/14	18/08/16	2 years	1.28%
West Dumbartonshire Council	£2.5m	26/03/14	24/03/17	3 years	1.60%
Perth & Kinross Council	£5m	23/03/14	24/03/17	3 years	1.45%

Economic Background (provided by Sector)

3.24 Comments on the economic background during the first quarter of 2014/15 and on the outlook are attached at Appendix 3.

Proposed changes to the Annual Investment Strategy

3.25 As is outlined in paragraphs 3.11 and 3.12, counterparty credit rating downgrades in recent years have resulted in the removal of (or the placing of restrictions on) many of our established counterparties from our lending list and it has become increasingly difficult to identify institutions to place money with. The restrictions on our lending list mean that we are almost always full to limit on eligible counterparties that are in the market for local authority cash. As a result, we have had to place large sums in low interest accounts and this has had a significant impact on the Council's interest earnings. At the time of writing this report (19th August 2014), around £87m is invested in non-fixed term deposit accounts (instant access and notice/call accounts). This comprises £37m in money market funds (currently earning an average of 0.42%), £20m in 95-day notice money (currently earning an average of 0.63%, but £15m of this is with RBS, who have announced a rate cut from 0.60% to 0.30% with effect from later in August), £15m in an instant access account with Svenska Handelsbanken (recently reduced from 0.60% to 0.50%) and a further £15m in the Payden Sterling Reserve Fund.

3.26 At the E&R PDS meeting in June, Members requested a report back to consider options for achieving greater returns by broadening the level of investments.

Increase in investment limits for part-nationalised banks Lloyds and RBS

3.27 A proposal to the Executive on 19th October 2011 to increase the lending limit for both of the part-nationalised banks (Lloyds and RBS) from £40m to £60m was approved, "subject to this being implemented after 3 months dependent on the prevailing financial position". At that meeting, concerns were expressed by Members at the recent downgradings of these banks and the continuing uncertainty in the money markets. As a result, they did not support increasing the lending limits at that time and the limits for the banks have remained at a total of £40m each

(around 13% of our total portfolio each) and a maximum investment term of 2 years. Since then, the credit ratings for Lloyds and RBS have not been revised upwards, although the economic situation has improved. In recognition of this, Sector has compiled a number of more positive comments recently made on the two banks by the three ratings agencies, Fitch, Moody's and S&P, and this is attached as Appendix 4.

3.28 In recognition of the fact that the banks are part-nationalised, Members are requested ***to consider increasing the total investment limit for the two part-nationalised banks, Lloyds and Royal Bank of Scotland, to £80m and the maximum investment period to 3 years***. Sector advise that the proposed increases would be prudent in the current economic climate and would involve minimal additional risk. They feel strongly that the government will not sell its interest in the two banks until it is sure both can stand on their own two feet, which may still be some time away and is very unlikely to happen before the next General Election.

3.29 An increase in the total lending limit would enable us to invest more money with both and, consequently, less money with low-interest instant access accounts and would bring us closer in line with many other local authorities, who have very high limits with the two banks. In a recent survey of London boroughs, the five authorities with the highest average returns were lending 50%, 63%, 54%, 74% and 94% of their total portfolios respectively to the two part nationalised banks (compared with 33% for Bromley). Some of the authorities had also extended their lending period with these banks. This would enable a total of an extra £80m to be invested with these two banks, which are currently offering around 2% for 3 years, potentially bringing in more than £1m in additional income in a full year at current rates (£80m @ 2% = £1.6m; current non-fixed term deposit earnings £87m @ 0.50% = £0.4m).

<u>Lowering the minimum credit rating for corporate bond investments (but still maintaining "investment grade" ratings)</u>

3.30 The use of corporate bonds was approved by Council in November 2012 and eligibility criteria were set, comprising a minimum credit rating of AA-, a maximum duration of 5 years and a maximum total exposure of £25m. In essence, companies issue bonds in order to raise long-term capital or funding, rather than issuing equity. These are non-standardised compared to other investment vehicles, each having an individual legal document known as a "bond indenture", which specifies the rights of the holder and the obligations that must be met by the issuer, as well as the characteristics of that particular bond.

3.31 Investing in a corporate bond usually offers a fixed stream of income, known as a coupon, payable twice a year, for a fixed, predetermined period of time in exchange for an initial investment of capital. Many investors prefer not to hold them until maturity, as they can often offer marginal capital growth, but trading before maturity can be very risky, especially during volatile times, and requires in depth fixed income knowledge and experience. For local authorities looking for a fixed income stream, however, the buy and hold strategy is far more appealing.

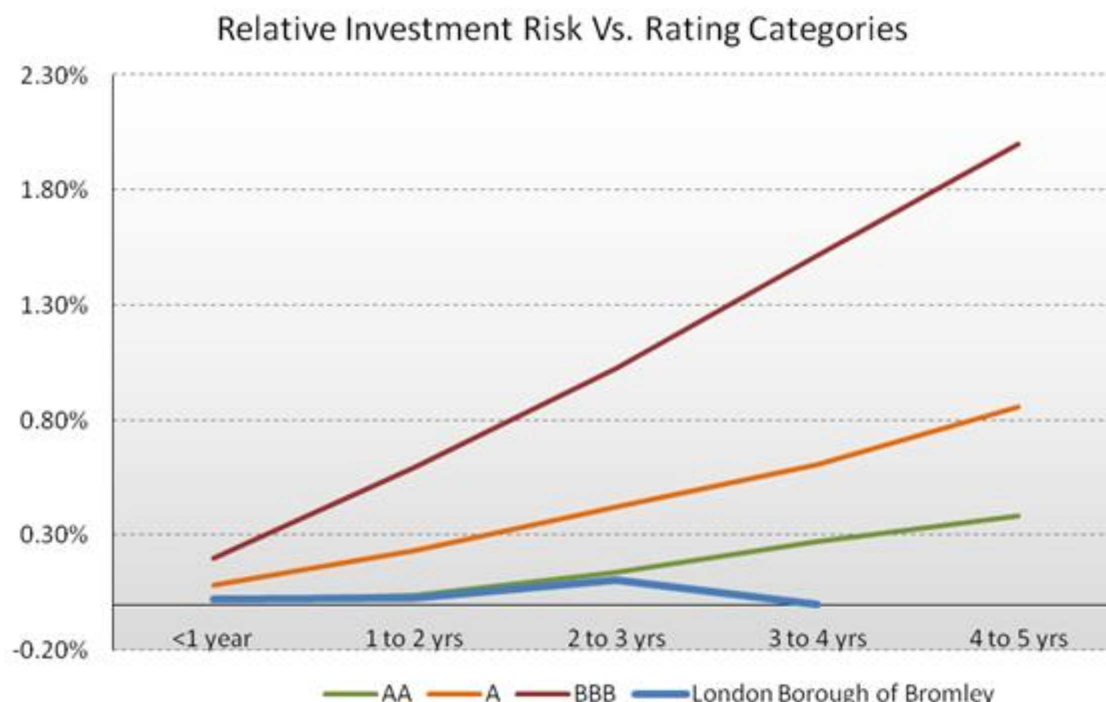
3.32 There are a number of benefits, drawbacks and risks to consider before and during investing in corporate bonds. The main benefits, drawbacks and risks are as follows:

Benefits / Counter measures	Drawbacks / Risks
Potential for higher returns than gilts and other assets	Higher perceived risk
Potential for greater liquidity than fixed term deposits (if sold before maturity)	Risk of capital loss (if sold before maturity)
Credit ratings, credit default swaps	Credit risk

NB. There are other risks, including interest rate risk, inflation risk, re-investment risk, default risk and call-in risk, most of which are the same for any type of investment. These will be controlled by risk management procedures built into the investment strategy and treasury management procedures and, as is always the case, potential investments will be discussed with external advisers.

3.33 In practice, the current minimum credit rating requirement has meant it has been difficult to identify good investment deals for the Council, as, generally, a bond with a higher credit rating will produce lower returns. As a result, only one bond has been bought to date (see paragraph 3.19). In consultation with Sector, ***it is proposed that the minimum credit rating for corporate bond investments be reduced to A-***. Given that we are using council taxpayers' money, we have to adopt the regulatory principles of security, liquidity and yield – in that order – and a minimum credit rating of A- would still represent a secure "investment grade" option. While it is true that a lower grade investment comes with a higher risk of default risk, moving to A- should give us more choice with minimal additional risk. It should be noted that the current criteria for fixed term deposits with banks and building societies already go down to a minimum of A-, although our Investment Strategy generally only permits short-term investments of up to 3 months with these institutions.

3.34 Sector have produced some analysis of the actual level of default over the last 5 years and this is attached as Appendix 5. While this does not necessarily relate exclusively to corporate bond issues, it shows that, certainly in 2013, the only defaults were relating to institutions with "Speculative-Grade" ratings (lower than BB-) and it demonstrates the general principle that lower ratings bring higher risk. For instance, were we to reduce the minimum rating down to BBB, we would, in relative terms, be taking on a considerable amount of additional risk. For ease of reference, the graph showing the historic risk of default is shown below. Sector estimate that, with a portfolio of A-rated investments, we could expect an estimated return of 0.80% and, if we went further down the ratings scale to BBB, we could expect an estimated return of 0.84%. In their view, it would not be worth taking on the extra risk of a portfolio of BBB rated investments in order to only gain around 0.04% increase in yield.



The table shown above has to be treated with some caution, as the defaults included in the base data related to non-UK institutions, However, the rating process and the measurement of the historic defaults measure the risk using the credit rating, irrespective of the economy so as to ensure they take a common and consistent approach across the world.

Investment in Diversified Growth Funds

3.35 The Director of Finance recently commissioned a report by an independent external adviser into other "alternative" investment options that would first and foremost protect the Council's

principal sums, whilst also providing a good degree of liquidity and good returns. This report proposes that we consider investing in a minimum of two investment managers offering diversified growth fund products, but who have clearly contrasting or complementary investment styles. Diversified growth funds are essentially medium to long term investment vehicles (i.e. three to five years) and it should be noted that any recall of funds before the three to five year period has elapsed will be likely to affect the overall return. The adviser's report is attached as Appendix 5.

3.36 In addition to the adviser's report, we separately asked the Council's five Pension Fund managers for their views on the alternative investments identified in the report. They all agree that the alternative investments provide reduced volatility (compared with equities) but their views differ on the timeframe required for such investment. Some agree a period of 3 to 5 years whilst others indicate that the investment timeframe should be 10 years. Given the Council's financial prospects, ten years would be too long to tie up such monies. A key point raised is the risk of the value going down and the need to understand that this would be a longer term investment (i.e. don't panic if values go down {UK commercial real estate market fell by 26.4% in 2008 but have bounced back} and in longer term it should be alright). Another key point is that the recession is cyclical and therefore you may have to be prepared to retain the investment until the current recession cycle is over. As always performance in the past is no guarantee of future performance for such investments.

3.37 At its meeting in February 2014, the Pensions Investment Sub-Committee felt that Diversified Growth Funds represented a good investment, as they are relatively low risk, liquid and have a good prospect of a reasonable return. The Council's Pension Fund already invests a total of around £70m in Diversified Growth Funds, having agreed an allocation of 10% of the total Fund to that asset class in the Strategy Review that took place in 2012. The £70m is managed by two managers, Baillie Gifford and Standard Life, who were appointed from December 2012 after a tender process. Given that the Baillie Gifford DGF offering is currently closed to additional money and that there have been significant recent staff changes at Standard Life, the adviser recommends that we look initially to invest a total of up to £15m with the two managers that came 3rd and 4th in the 2012 selection process. If the principle of a treasury management DGF investment is agreed, this will be looked at further. In terms of our existing Treasury Management Investment Strategy, an investment of up to £15m would be permitted as a collective (pooled) investment scheme. This investment category was added in October 2013 as an eligible investment vehicle in the Council's Investment Strategy with an overall limit of £25m and a maximum duration of 5 years. To date, a total of £10m has been invested in the CCLA Property Fund and ***Members are asked to agree that up to £10m be invested in Diversified Growth Funds***.

Regulatory Framework, Risk and Performance

3.38 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions have been made in any year(s);

- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;

- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities;
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

3.39 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

4. POLICY IMPLICATIONS

4.1 In line with government guidance, the Council's policy is to seek to ensure the security of the Council's investments, to achieve liquidity and to achieve the highest rate of return on investments whilst maintaining appropriate levels of risk.

5. FINANCIAL IMPLICATIONS

5.1 An average rate of 1% has been assumed for interest on new investments in the 2014/15 revenue budget, in line with the estimates provided by the Council's external treasury advisers, Sector, earlier in the year and with officers' views. The Bank of England base rate is still expected to rise, but Sector now anticipate the rise will start in early-2015, although it could be later. For planning purposes, the latest financial forecast assumes 1% for new investments in all years from 2014/15 to 2017/18. As in previous years, the level of returns achieved will depend on the rates available in the market place working within the Council's approved investment framework. A variation of 0.25% in these assumptions would result in a variation in interest earnings of around £400k pa from 2014/15. The net budget for interest on balances (after deducting interest payable to internal funds) was set at £1.6m and, at this stage in the year, it is forecast that the 2014/15 outturn will be broadly in line with the budget.

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	CIPFA Code of Practice on Treasury Management CIPFA Prudential Code for Capital Finance in Local Authorities CLG Guidance on Investments External advice from Sector Treasury Services