MEDIUM TERM FINANCIAL STRATEGY 2018/19 – 2022/23

CAPITAL AND TREASURY MANAGEMENT STRATEGY 2018/19

1.1 This item of business was referred by the Review Committee on 6 February 2018 to Council with a recommendation on the Council's Capital and Treasury Management Strategy 2018/19. A copy of the report of the Section 151 officer to the Review Committee can be found at appendix 4 of Council Item 3 (pages 3.111 to 3.141). An addendum provided to the Review Committee on possible options in relation to inter-authority lending is appended to this report.

1.2 The strategy was scrutinised by the Review Committee in line with the requirements of the Prudential Code for Capital Finance in Local Authorities.

1.3 In response to a question, the Section 151 Officer confirmed that the Council's Treasury Management advisers, Link Asset Services, did not undertake credit rating for individual Local Authorities.

1.4 In response to a question as to how the officers had reached the recommendation to keep the category of lending to other local authorities in the strategy, the Committee was advised that professional advice had been taken from the Council's Treasury Management advisors as well as communication undertaken with the peer group. The majority of other Councils included this option of lending in their Treasury Management Strategy. The Ministry for Housing, Communities and Local Government (MHCLG) classified Local Authorities under the same heading as Central Government in its list of specified investments within its latest statutory guidance on Local Government Investments. Although all investments had risk attached, the Council's priorities remained focussed on security and liquidity before yield was considered and officers believed that there was adequate security in inter-authority lending when taken as part of a balanced portfolio of investments.

1.5 The Section 151 Officer added that, if the Council was to choose to go down the route of making such investments, it could establish a framework of checks in advance of any offers coming through from other local authorities. These checks could include a review of the local authority's financial statements or balance sheet for the previous two years, which would be a relatively quick and easy way of showing the financial health of the authority. A Member observed that a full picture of the financial health of a local authority could not be ascertained from a balance sheet as this would not provide the debt profile or current financial circumstances of a Council in sufficient detail to ensure an adequate credit risk analysis.

1.6 The Portfolio Holder for Finance indicated that this would be a relatively small change of establishing a framework of checks before lending to other Local Authorities. The option to lend to other local authorities had not to this point been taken up and would not be a principal method of investing, but provide a greater number of investment options. The underlying priorities of the Council's investment strategy were security and liquidity and the Council was not looking for high yield or high risk as it was a cautious investor and had been for a number of years.

1.7 The Council looked carefully before selecting investments and sought advice from Link Asset Services, who advised that investment in other local authorities continued to be acceptable. However, the same system of credit rating could not be used for local authorities as would be used for other financial institutions.

1.8 A Member referred to potential risk associated with lending to local authorities in the light of news stories on the financial difficulties of Northampton County Council and potentially other authorities, and because there is no form of credit rating for most local authorities.

1.9 In response to a question regarding how much more interest the Council would earn from lending to a local authority as opposed to a fully credit rated bank and whether the risk was worth taking, the Committee was advised that local authorities were offering higher interest rates. Specifically, the overnight deposit rate for the Council's Lloyds Bank current account had been 0.2%; 0.6% could have been achieved by investing with a local authority. The Committee was asked to be provided with a monetary value of the difference of 0.4% that could be achieved by investing with a local authority compared with Lloyds Bank.

1.10 In response to a question around why Rochford, as a cautious Council, would continue to include inter-authority lending as an option for investment when it had not taken up this option previously and when it was apparent that some local authorities had financial difficulties, the Committee was advised that the primary reason for keeping this option on the lending list was not for financial return. Local authorities had been on the lending list until now and there had not been a serious increase in risk in the previous twelve months. If the Council's risk appetite was now more risk averse in light of recent press, the Strategy could be amended. The Council had not chosen to exercise this option in the past; however, if it were to adopt a less risk adverse stance in future the option of inter-authority lending could be re-considered for inclusion in the Strategy. It was further stated that it was not practicable to maintain a list of authorities that the Council would consider lending to although, potentially, a list of those that would definitely not be invested in could be compiled.

1.11 It was confirmed that Council would decide whether or not to include inter-authority lending when it approved the Treasury Management Strategy and the Section 151 Officer had delegated authority to determine the individual investment decisions in line with the Strategy. The Review Committee could recommend to Council the Strategy as it stands or with amendments.

1.12 In response to a request for clarification of the meaning of ‘expected investments’ (which had risen from £3m to £6.6m from 2017/18 to 2021/22) in the table in paragraph 6.1 of the report, the Committee was advised that these were expected level of reserves at the end of each financial year, given the Council’s predicted income levels but without major project spend, which was not yet agreed.

1.13 In terms of borrowing in advance of need, the Committee felt that that paragraph 9.5, ‘it is unlikely that the Council will require any borrowing in advance of need’ should be moved to the beginning of Item 9 and that, for clarity, paragraph 9.3 should be reworded to state that the Section151 Officer had delegated authority to borrow in advance of need.

1.14 In response for a request for clarification, the Section 151 Officer confirmed that, under the new banking regulations (MiFID 11) the Council, along with the majority of local authorities, had elected to opt up to professional status, which enabled it to continue to invest in a wider range of funds in accordance with its Investment Strategy. It the Council had remained as a Retail Counterparty, this would have impinged on its ability to invest in investments currently on the list, including in money market funds. The Council had met the level of balances required and had sufficient suitably experience staff to enable it to opt up. The Section 151 Officer would check whether there would be a specific impact on lending to Local Authorities if the Council were to remain as a Retail Counterparty and would establish if or when the Council’s classification would be reassessed.

2 RECOMMENDATION

2.1 It is proposed that Council **RESOLVES** that the Capital and Treasury Management Strategy for 2018/19 be adopted subject to removal of the option of Inter-Authority lending from the proposed lending list for 2018/19 and adjustments to paragraphs within Item 9 (Borrowing in Advance of Need) as mentioned in Paragraph 1.13 above.

If you would like this report in large print, Braille or another language please contact 01702 318111.

Briefing on RDC Approach to Inter Authority Lending

For **information**	X
For **decision**	X
For **discussion**	X

Purpose

To advise Members of the Council's proposed approach to inter-authority lending, as set out in the draft 2018/19 Capital and Treasury Management Strategy.

Proposal / recommendations

To note the contents of this briefing, including the potential options available to RDC to be discussed at the Review Committee meeting on 6th February, and decide whether to recommend any changes to the draft strategy before it is taken to Full Council for approval.

Background

The draft 2018/19 Capital and Treasury Management Strategy is appended to this note and will be discussed at the Review Committee meeting on 6th February before it is taken to Full Council on 13th February for approval.

The draft strategy currently recommends that the list of counterparties that Rochford District Council (RDC) will lend to remains unchanged from the 2017/18 list. This includes the ability to lend up to £3m to other Local Authorities for periods of up to one year.

At the Review Committee meeting of 5th December a question was raised regarding the security of Treasury Management investments made in other Local Authorities. A follow up response was sent to all Members of that Committee on 8th December as follows:

The 2017/18 RDC Treasury Management Strategy sets out the criteria for the counterparties the Council will lend to. This states that the Council will only invest with institutions within countries that have a sovereign credit rating of AA+ or above (with the exception granted by Full Council of the UK which has an AA rating) and in items which fall under the following headings:

- *Term and Call Deposits with banks and building societies*
- *Term deposits, call deposits and bonds with other UK Local Authorities*
- *Certificates of deposit with banks and building societies*
- *Deposit Facility*
- *Money Market funds (both Standard and Enhanced)*
- *Debt Management Agency Deposit Facility (Government Managed)*

- *Treasury Bills*

Under the criteria of the current strategy the Council could therefore choose to invest with other UK Local Authorities, although to date it has not done so.

While there is no specific guarantee from Central Government to underwrite Local Authority lending in the Local Government Act 2003, no Local Authority has become insolvent to date and it seems very unlikely that Central Government would allow an individual Local Authority to default against its creditors. It is therefore judged that lending to another UK Local Authority is unlikely to be riskier than investing in a bank or building society that falls under a similar national sovereign credit rating. The risk is further mitigated by the limits on lending to other Local Authorities set out in the Council's 2017/18 Strategy, which states that a maximum of £3m may be lent for a maximum duration of 1 year.

It was officers' view, in consultation with the Portfolio Holder for Finance, that the option to lend to other Local Authorities should therefore remain in the 2018/19 draft strategy (pending further discussion at Review Committee) as the security of these investments is not deemed to have changed materially since 2017/18 and it allows the potential for increased diversification of risk across the Councils investment portfolio as well as a greater flexibility of investment options and potentially greater returns on investment.

Since December officers have undertaken further due diligence by speaking with its Treasury Management Advisors, and peer authorities to establish what checks and controls other authorities undertake before agreeing inter-authority lending, and the key points arising from this are summarised below.

- RDCs Treasury Management Advisors, Link Asset Services (LAS), continue to include UK Local Authorities on their recommended lending list, however, they are not given a credit score.

- Most Local Authorities are not individually credit rated, therefore LAS form their view on the security of local authority investments across the local government sector as a whole.

- Some Local Authorities have registered for individual credit ratings; this is mainly where they have chosen to issue bonds on the market e.g. Cornwall County Council and Lancashire County Council.

- Most Local Authorities do allow inter-authority lending to other councils, subject to controls to limit exposure to investment risks e.g. through caps on the amounts and length of time that these can be invested. For example ECC includes other local authorities within their counterparty 'pool' and determines the total amounts that can be invested with regard to their size i.e. upper or lower tier. Castlepoint allows up to 33% of total investments (or £5m if lower) to be invested with other Local Authorities for up to a year, and deems the security of these to be high. Similarly Maldon allows investment with other Local Authorities and states that there is an insignificant risk of insolvency on these investments.

- Some authorities do undertake further checks on the individual Local Authority before agreeing to invest, e.g. by reviewing their balance sheet position to assess their financial health; however there is not one approach to the checks that should be undertaken.

- Any further checks to be undertaken before investing have to be proportionate, as officers need to act quickly when making investment decisions - typically these have to be undertaken within an hour or so of receiving an offer from a broker.

Potential Options for Consideration by Review Committee:

1. Recommend the TM Strategy as it currently stands to Full Council for approval.

2. Recommend that the lending list in the 2018/19 Strategy stays as it currently stands, but expand the TMP 4 Section of its TM Practices section, to set out the additional checks that will be undertaken before lending to other Local Authorities (note further work may need to be undertaken to establish what these checks should be; however if this option is agreed RDC would not invest in other Local Authorities until such time at this was agreed by Review Committee).

3. Revise the amount and/or duration that can be lent to other Local Authorities.

4. Add further detail on limits e.g. separate limits for lending to upper and lower tier authorities.

5. Remove the option to lend to other Local Authorities completely from the lending list for 2018/19*.

   *It should be noted that if option 5 is agreed, this will potentially increase other TM risks to the Council i.e. by limiting the lending list further this will decrease the diversity of potential investment opportunities and increase the likelihood that the council's monies are invested predominately in one sector e.g. banking.

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Appendix 1 – Draft 2018/19 Capital and Treasury Management Strategy

Item 8 Report: Capital & Treasury Management Strategy 2018/19: Review Committee – 06/02/2018