Buckinghamshire & Milton Keynes Fire Authority

MEETING	Overview and Audit Committee
DATE OF MEETING	15 November 2017
OFFICER	David Sutherland, Director of Finance and Assets
LEAD MEMBER	Councillor Peter McDonald
SUBJECT OF THE REPORT	**Treasury Management Strategy Development**
EXECUTIVE SUMMARY	At the meeting of the Overview and Audit Committee on 26 July 2017 it was agreed that a paper would be brought to the next meeting of the Committee setting out potential ways to diversify the investment portfolio. Feedback from Members will be used to help inform the development of the Treasury Strategy for 2018-19.
ACTION	Decision.
RECOMMENDATIONS	Members are asked to resolve whether each of the following recommendations should be included within the Treasury Management Strategy for 2018/19 that will be considered for approval by the Fire Authority (based on recommendation from the Executive Committee): 1. That the duration limit to be used for 2018/19 should be the Capita recommended limit plus six months (e.g. the limit for counterparties rated 'Red' will be 1 year). 2. That the limit of 100 days is removed from non-UK based counterparties and that the duration limit is as per the Capita rating (but not including the plus six months option in Recommendation 1). 3. Any counterparty rated at least 'Green' by Capita should be added to the counterparty list regardless of location. 4. The top-ten building societies (by group assets) should be added to the counterparty list. The duration of investment will be limited to 1 year and the total amount invested with any one non-rated building society at any point in time will not exceed £2 million. 5. That up to £3 million can be invested in a

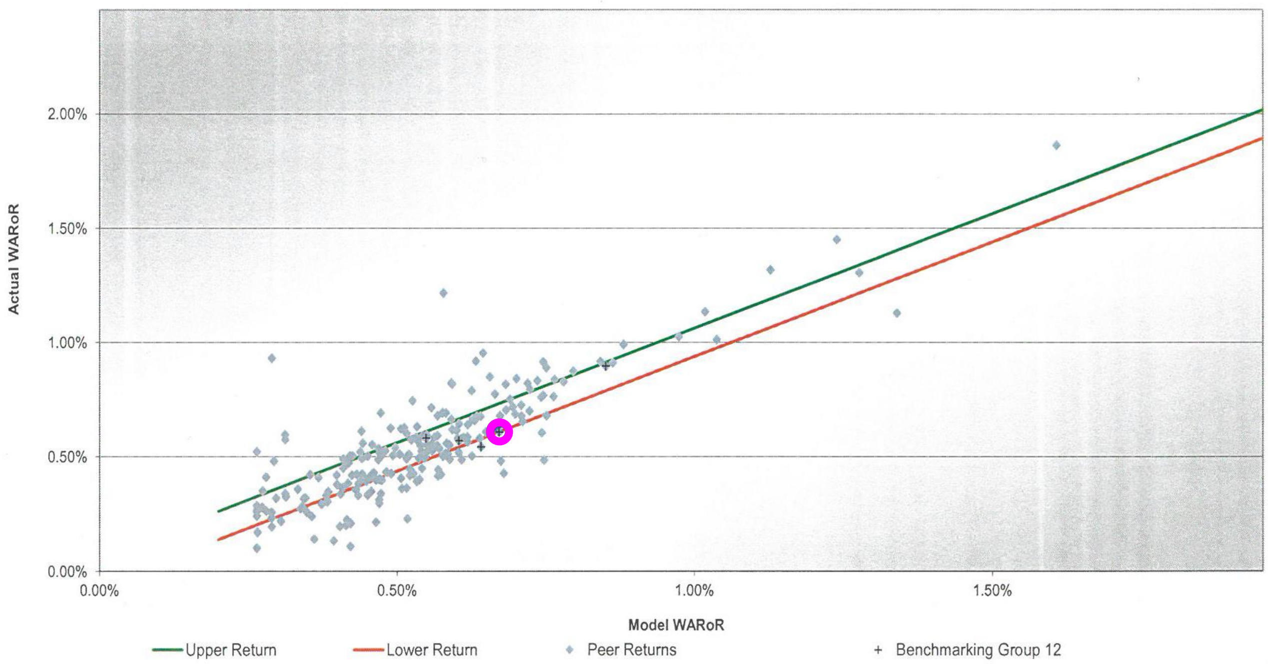
	property fund.
RISK MANAGEMENT	Making investments in the Authority's own name means that the Authority bears the risk of any counterparty failure. This risk will be managed in accordance with the strategy and with advice from external treasury management advisors. The Director of Finance and Assets will act in accordance with the Authority's policy statement; treasury management practices and CIPFA's Standard of Professional Practice on Treasury Management. There are no direct staffing implications.
FINANCIAL IMPLICATIONS	The current budget for income from investments is £100k. The latest forecast outturn position is £150k. Implications of each recommendation are contained within Appendix A.
LEGAL IMPLICATIONS	The Authority is required by Section 15(1) of the Local Government Act 2003 to have regard to the Department for Communities and Local Government Guidance on Local Government Investments; and by regulation 24 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146] to have regard to any prevailing CIPFA Treasury Management Code of Practice. Under Section 12 of the Local Government Act 2003 the Authority has the power to invest for "any purpose relevant to its functions" and "for the purposes of the prudent management of its financial affairs". However it must exercise its investment power in accordance with its fiduciary duty, analogous to that of a trustee, owed to those who contribute to the funds of the Authority.
CONSISTENCY WITH THE PRINCIPLES OF THE DUTY TO COLLABORATE	No direct impact.
HEALTH AND SAFETY	No direct impact.
EQUALITY AND DIVERSITY	No direct impact.
USE OF RESOURCES	See Financial Implications.
PROVENANCE SECTION & BACKGROUND PAPERS	**Background** Treasury Management Strategy 2017-18, Fire Authority, 15 February 2017: http://bucksfire.gov.uk/files/4314/8639/2930/ITEM_8

	Treasury Management Strategy 2017-18 Final.pdf
APPENDICES	Appendix A – Current Performance and Potential Developments to the Treasury Strategy Appendix B – Capita Credit Ratings List as at 27 October 2017 Appendix C – Building Societies Group Assets as at August 2017
TIME REQUIRED	15 minutes.
REPORT ORIGINATOR AND CONTACT	Mark Hemming mhemming@bucksfire.gov.uk 01296 744687

Appendix A – Current Performance and Potential Developments to the Treasury Strategy

The Authority is part of a local authority investment benchmarking group. This helps to highlight the performance of the Authority relative to its peers. Although the other members of the group are district/borough councils with larger investment balances, the information does indicate some potential variations to the current strategy that could improve performance.

The chart below shows the actual investment returns versus the modelled rate of return (i.e. the return that should be achieved based on the level of risk inherent within each authority's strategy).



BMKFA's performance is circled. This indicates that the returns being achieved are consistent with the expected returns, but that other authorities with different strategies are achieving greater rates of return.

The remainder of this paper considers potential amendments to the current strategy and the pros and cons of each.

<u>Duration of Investments</u>

The maximum duration of investments is based on an approach devised by our external treasury advisors (Capita). This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of credit-default swaps (CDS) spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Authority to determine the suggested duration for investments. As per the current strategy, the maximum durations are:

- Yellow 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)

- Orange 1 year
- Red 6 months
- Green 3 months
- No colour not to be used

The following table shows the average length of investments for each authority in the benchmarking group:

	BMKFA	Authority A	Authority B	Authority C	Authority D
Weighted Average Maturity (days)	**58**	119	180	198	127

This indicates that the Authority could potentially benefit from lengthening the duration of investments. The Authority has recently placed two longer term investments of £2m each with other local authorities. The investment durations are for 3 and 2 years with a return of 0.90% and 0.72% respectively. However, the number of authorities seeking investment in this way is small and opportunities to invest are limited. It would be beneficial if the Authority could lend to existing counterparties for a longer duration. This will increase the risk slightly but will offer increased returns. As an example the rate offered by Barclays at the beginning of October was 0.40% for six months, which increased to 0.68% for one year.

Recommendation 1 – that the duration limit to be used for 2018/19 should be the Capita recommended limit *(see above bullet points and also Appendix B)* plus six months (e.g. the limit for counterparties rated 'Red' will be 1 year)

The current strategy also limits investments with non-UK based counterparties to 100 days. There is no evidence to suggest that non-UK based counterparties with equivalent Capita ratings to their UK based counterparts represent a greater investment risk (although in the unlikely event of default, it may be harder to recover sums invested).

Recommendation 2 – that the limit of 100 days is removed from non-UK based counterparties and that the duration limit is as per the Capita rating *(see Appendix B)* but not including the plus six months option in Recommendation 1

Counterparty Location

When treasury management was first brought in-house, Members resolved that all investments should be placed with UK based counterparties. For 2014/15 it was resolved to add a limited number of non-UK based counterparties. The benchmarking group has indicated a number of other possible counterparties that could be added to the list. This would not increase risk but would offer additional investment opportunities.

Recommendation 3 – any counterparty rated at least 'Green' by Capita *(see Appendix B)* should be added to the counterparty list regardless of location

Unrated Counterparties

By adding more building societies to the counterparty listing the Authority would create diversity and greater liquidity of its investments. The Authority's current lending list is weighted towards the UK banks. UK Building Societies are considered to be of "high credit quality" and comfort can be taken from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Council's deposits would be paid out in preference to retail depositors.

Building societies have an unparalleled record of investor safety. No investor (retail or wholesale) has lost money invested with a building society at least since the Second World War. Although the banking crisis exposed imprudent behaviour elsewhere, the building society sector remains sound and secure for several reasons.

1. The statutory framework of the Building Societies Act 1986, substantially revised in 1997, enshrines a relatively prudent business model. Societies must raise the majority of their funds (at least 50%) from their members' savings, and the vast majority of their business (at least 75%) must be fully secured residential mortgages. There are statutory restrictions on riskier forms of financial trading: unlike banks, societies cannot trade in currencies or commodities, they cannot make markets in securities, and their use of financial derivatives is limited to the management of their own risks.

2. All building societies are "credit institutions" for the purposes of the EU Banking Directives, and are required to meet the same standards for capital adequacy and risk control as UK and other EU banks. Societies have, moreover, not needed to be "recapitalised" at the taxpayers' expense.

3. Where occasionally a society has encountered difficulties, a merger with a stronger society has ensured that both retail savers and wholesale depositors experience no uncertainty or interruption to service. The building society sector has continued to support intra-sector mergers, which require no taxpayer funding.

In terms of potential returns, a number of other authorities in the benchmarking group have relatively recent one-year investments achieving returns in excess of 0.75% (compared to the 0.68% noted for Barclays earlier in the paper).

Recommendation 4 – the top-ten building societies by group assets *(see Appendix C)* should be added to the counterparty list (if not already rated by Capita). The duration of investment will be limited to 1 year and the total amount invested with any one non-rated building society at any point in time will not exceed £2 million.

<u>Property Funds</u>

Property funds are a pooled investment vehicle and invest in UK focused commercial and industrial property.

The advantages of investing in a Local Authority Property Fund are that the investment made by purchasing units in a pooled investment fund which therefore offers the benefit of diversification in property portfolio across the UK, rather than investing solely in our own area. This spreads risk in cases where there may be a local downturn in property prices/rents. Funds also earn rent as well as capital appreciation. The downside risk is that property values can go up as well as down. Because of entry and exit fees, investments ideally need to be placed for a minimum of three years, although at least five years would be preferable.

The table below shows the performance of the best and worst performing funds over the last 3 months and up to 10 years:

Fund Performance (Net) 31/12/16	Best Performing Fund (%)	Worst Performing Fund (%)
3 Month	2.8	-0.1
1 Year	5.6	1.6
3 Year (Annualised)	13.8	7.6
5 Year (Annualised)	11.0	6.1
10 Year (Annualised)	4.6	1.1

An alternative to a property fund may be to invest in local property. The advantage is that this could be used to help further service aims, but with the drawback being that all the risk is concentrated in a small number of assets.

Recommendation 5 – that up to £3 million can be invested in a property fund

Appendix B – Capita Credit Ratings List as at 27 October 2017

Counterparty	Suggested Duration
First Abu Dhabi Bank PJSC	O - 12 mths
Australia and New Zealand Banking Group Ltd	O - 12 mths
Commonwealth Bank of Australia	O - 12 mths
Macquarie Bank Limited	R - 6 mths
National Australia Bank Ltd	O - 12 mths
Westpac Banking Corporation	O - 12 mths
BNP Paribas Fortis	R - 6 mths
KBC Bank NV	R - 6 mths
Bank of Montreal	O - 12 mths
Bank of Nova Scotia	O - 12 mths
Canadian Imperial Bank of Commerce	O - 12 mths
National Bank of Canada	R - 6 mths
Royal Bank of Canada	O - 12 mths
Toronto Dominion Bank	O - 12 mths
Danske Bank	R - 6 mths
OP Corporate Bank plc	O - 12 mths
BNP Paribas	R - 6 mths
Credit Agricole Corporate and Investment Bank	R - 6 mths
Credit Industriel et Commercial	R - 6 mths
Credit Agricole SA	R - 6 mths
Societe Generale	R - 6 mths
BayernLB	R - 6 mths
Commerzbank AG	G - 100 days
Deutsche Bank AG	G - 100 days
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	O - 12 mths
Landesbank Baden Wuerttemberg	R - 6 mths
Landesbank Berlin AG	O - 12 mths
Landesbank Hessen-Thueringen Girozentrale (Helaba)	O - 12 mths
Landwirtschaftliche Rentenbank	P - 24 mths
NRW.BANK	P - 24 mths
ABN AMRO Bank N.V.	R - 6 mths
Bank Nederlandse Gemeenten	P - 24 mths
Cooperatieve Rabobank U.A.	O - 12 mths
ING Bank NV	O - 12 mths
Nederlandse Waterschapsbank N.V	P - 24 mths
Qatar National Bank	G - 100 days
DBS Bank Ltd	O - 12 mths
Oversea Chinese Banking Corporation Ltd	O - 12 mths
United Overseas Bank Ltd	O - 12 mths
Nordea Bank AB	O - 12 mths
Skandinaviska Enskilda Banken AB	O - 12 mths
Swedbank AB	O - 12 mths
Svenska Handelsbanken AB	O - 12 mths
Credit Suisse AG	R - 6 mths
UBS AG	O - 12 mths
Abbey National Treasury Services plc	O - 12 mths

Counterparty	Suggested Duration
Bank of Scotland Plc	R - 6 mths
Barclays Bank plc	R - 6 mths
Close Brothers Ltd	R - 6 mths
Goldman Sachs International Bank	R - 6 mths
HSBC Bank plc	O - 12 mths
Lloyds Bank Plc	R - 6 mths
Santander UK plc	R - 6 mths
Standard Chartered Bank	R - 6 mths
Sumitomo Mitsui Banking Corporation Europe Ltd	R - 6 mths
UBS Ltd	O - 12 mths
Bank of America, N.A.	O - 12 mths
Bank of New York Mellon, The	P - 24 mths
Citibank, N.A.	R - 6 mths
JPMorgan Chase Bank NA	O - 12 mths
Wells Fargo Bank NA	O - 12 mths
Coventry BS	R - 6 mths
Leeds BS	G - 100 days
Nationwide BS	R - 6 mths
Skipton BS	G - 100 days
Yorkshire BS	G - 100 days

Appendix C – Building Societies Group Assets as at August 2017

Building Societies Association

Factsheet

August 2017

This table shows the assets of UK building societies, ranked by group assets, taken from their latest annual reports. These figures have not been adjusted to take account of any mergers, transfers of engagements or purchases of mortgage portfolios that have taken place since the societies' financial year end.
* The Society has no Group - the Society Assets figure has been repeated in the Group Assets field.

Rank by Group Assets	Name of Society	Financial Year Ended	Society Assets £m	Group Assets £m (see note *)
1	Nationwide	04 April 2017	220,013	221,670
2	Yorkshire	31 December 2016	45,162	39,596
3	Coventry	31 December 2016	37,632	38,296
4	Skipton	31 December 2016	17,827	19,020
5	Leeds	31 December 2016	16,485	15,930
6	Principality	31 December 2016	8,124	8,281
7	West Bromwich	31 March 2017	5,839	5,831
8	Newcastle	31 December 2016	3,638	3,622
9	Nottingham	31 December 2016	3,601	3,591
10	Cumberland	31 March 2017	2,242	2,242
11	National Counties	31 December 2016	1,863	1,865
12	Progressive*	31 December 2016	1,795	1,795
13	Saffron	31 December 2016	1,112	1,115
14	Cambridge	31 December 2016	1,114	1,109
15	Monmouthshire	30 April 2017	1,053	1,054
16	Newbury	31 October 2016	939	939
17	Leek United	31 December 2016	928	928
18	Furness	31 December 2016	814	816
19	Hinckley & Rugby*	30 November 2016	637	637
20	Ipswich*	30 November 2016	584	584
21	Darlington	31 December 2016	549	547
22	Melton Mowbray	31 December 2016	418	419
23	Market Harborough	31 December 2016	418	418
24	Marsden*	31 December 2016	416	416
25	Scottish	31 January 2017	409	409