

# Treasury Management Strategy 2021/22 - Appendix 1 Annex 2

Cabinet

Date: 3<sup>rd</sup> February 2021

## Annex 2 – Credit and Counterparty Risk Management, Specified and Non- Specified Investments

### 1 Treasury Management Practices – Treasury Investments

- 1.1 The MHCLG issued Investment Guidance in 2018, and this forms the structure of the Council's policy.
- 1.2 The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on the 1<sup>st</sup> April 2008 and will apply its principles to all investment activity. In accordance with the Code, the Corporate Director of Finance and Assets has produced its Treasury Management Practices (TMPs). This part, (TMP1), covering investment counterparty policy requires approval each year.
- 1.3 **Annual investment strategy** - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:
  - The strategy guidelines for choosing and placing investments, particularly non-specified investments.
  - The principles to be used to determine the maximum periods for which funds can be committed.
  - Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
  - Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

### 2 Treasury Management Practices – Non-Treasury Investments

- 2.1 The Council's Capital Strategy contains the criteria that will be adhered to when Non-Treasury investments are being considered, they are replicated here to enable all of the indicators to be consolidated in one place. (Annex 3 to the Capital Strategy)

#### Risk management

- 2.2 All business case proposals will clearly identify risk to ensure these are acceptable to the Council with a clear focus on the impact of the downside risk on the overall sustainability of the authority.

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- 2.3 Managing the Council's risks is an area of significant focus for senior management and members, and risk management is at the heart of all investment as well as operational decisions.
- 2.4 The Council aims to minimise its exposure to unwanted risks – those risks that are not actively sought and which carry no commensurate reward for the Council – through a range of mitigation strategies to the extent that it is cost-effective to do so. Specifically, the Council has no appetite for reputational risk, governance risk and currency risk.
- 2.5 The following local indicators will be used to assess the Council's total risk exposure as a result of its commercial investment decisions and will form part of the treasury management out-turn report
- Total Investment in commercial undertakings by Property/Other
  - Total Investment funded through borrowing
  - Average investment return before financing costs
  - Total investment income as a proportion of the Council's Net General Fund budget
  - Investment borrowing as a proportion of total external debt as measured by the Capital Financing Reserve (excl. lease liabilities and HRA)
  - Fair value of property investments as a proportion of all Council property assets
- 2.6 In considering risk, it is vital that not only the risks of individual investments are considered but also the cumulative impact of all the investments made by the authority and the interaction of individual risks. The Commercial Investment Strategy Board will therefore review the overall portfolio in light of current market and other risks.
- 2.7 The limits on loans by type are as follows:
- Wholly owned companies and joint ventures - £51m
  - Local Enterprises and charities - £1m

## **Performance, measurement and management**

- 2.8 The Commercial Investment Strategy Board will receive regular reports setting out the performance and current risk in relation to the overall investment portfolio.
- 2.9 Regular monitoring of the portfolio will identify any changes in Security, Liquidity and Yield and will also identify any lifecycle costs required to maintain the income potential of any property based assets. Values will also be regularly assessed to identify any significant changes in the value of the investments and market conditions that might impact upon this.
- 2.10 Any material change in the investment risk or threat to ongoing yield will be reported immediately to the next Board meeting (or immediately to the Chair if urgent action is required) so that mitigating action can be established. In considering risk, it is vital that not only the risks of individual investments are considered but also the cumulative impact of all the investments made by the authority and the interaction

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of individual risks. The Commercial Investment Strategy Board will therefore review the overall portfolio in light of current market and other risks.

## **Decision making, governance and organisation**

- 2.11 All Commercial Investment proposals must be taken through the Commercial Investment Strategy Board ("CISB") in the form of a business case which sets out the financial implications and the risks.
- 2.12 The Board is chaired by the Cabinet Member for Finance, Education and Skills and is attended by the Chief Executive and Corporate Director of Finance and Assets. It meets monthly to review all proposals. If successful they either proceed to Cabinet for approval if the investment required is greater than £10m, or through a Cabinet Member Decision Note process if less than £10m. In addition, there is a CMAG (Cabinet Member Advisory Group) for additional scrutiny and comment.
- 2.13 The CISB will also obtain external expert advice if required, including additional legal advice if required, and has procured expert commercial property advice for this purpose as it continues to look for commercial property investments to support the budget.
- 2.14 The CISB has also approved a Property Acquisition and Disposal Strategy which sets out a number of criteria by which property investment proposals will be assessed. These are covered in the Capital Strategy, (this forms part of the Capital Report elsewhere on this agenda).
- 2.15 Proposals other than those assessed against the criteria in the Property Investment and Disposal Strategy will be assessed against the following criteria:
- Is the overall profit acceptable to the risk?
  - Are the timescales for returns realistic and acceptable?
  - Are the risks acceptable and/or controllable?
  - Is the investment required proportional to the level of resources available to the Authority?
  - Is external expertise required to fully understand the business case proposal and risks?
- 2.16 The purpose of the criteria set out above is to set a framework by which to assess commercial proposals and ensure consistency is applied when making decisions.

## **Training and qualifications**

- 2.17 Hartnell Taylor Cook, a firm of specialist commercial property consultants, have been procured to offer external expert advice on proposed purchases as well as an overview of the overall Council portfolio to ensure the portfolio is balanced, and risks are actively identified and managed.
- 2.18 The Council has also engaged specialist accounting and financial advisors to support this process.

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- 2.19 The training needs of property management officers are kept under review, and officers attend training events and seminars held by CIPFA and other Training Organisations relevant to their professional qualifications.

## 3 Specified/Non-Specified Investments

- 3.1 The main strategy guidelines are contained in the body of the Treasury Strategy statement. The paragraphs below detail the Council's use of Specified and Non-Specified Investments
- 3.2 **Specified Investments** – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:
- The UK Government (such as the Debt Management Account deposit facility (DMADF), UK Treasury Bills or Gilt with less than one year to maturity).
  - Supranational bonds of less than one year's duration.
  - A local authority, parish council or community council.
  - Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. This covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.
  - A body that is considered of a high credit quality (such as a bank or building society) in accordance with the Council's creditworthiness Policy.
- 3.3 Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. The Council has historically maintained a position of minimising investment balances and using these to reduce the requirement for borrowing. The investments made by the Council will therefore be timed to coincide with predicted day to day treasury requirements and thus are primarily of a short term nature.
- 3.4 **Non-Specified Investments** – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The Council holds 5 types of non-specified investments:
- Cash deposits > 1 year (Category (e) below)
  - Share Capital (Category (f) below)
  - Loan Capital (Category (g) below)
  - The Local Authority Property Fund (Category (i) below).
  - Loan to local Charity (Category (j) below).

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Other Non-specified investments that the Council could make would include any investments with:

|          | Non Specified Investment Category  |
|----------|--|
| <b>a</b> | <p><b>Supranational Bonds greater than 1 year to maturity</b></p> <p><b>Multilateral development bank bonds</b> - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Reconstruction and Development Bank etc.).</p> <p><b>A financial institution that is guaranteed by the United Kingdom Government</b> (e.g. National Rail)</p> <p>The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.</p> |
| <b>b</b> | <p><b>Gilt edged securities</b> with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.</p>  |
| <b>c</b> | <p><b>The Council's own banker</b> if it fails to meet the basic credit criteria. In this instance any balances will be maintained on an instant access basis</p>  |
| <b>d</b> | <p><b>Building societies not meeting the basic security requirements under the specified investments.</b> The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies but will take specific advice before doing so.</p>  |
| <b>e</b> | <p>Any <b>bank or building society</b> that complies with the Council's creditworthiness policy for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).</p>   |
| <b>f</b> | <p><b>Share capital</b> in a body corporate – The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be invested in corporate bodies. See note 1 below.</p>   |
| <b>g</b> | <p><b>Loan capital</b> in a body corporate. See note 1 below.</p>  |
| <b>h</b> | <p><b>Bond funds.</b> See note 1 below.</p>  |
| <b>i</b> | <p><b>Property funds</b> – The use of these instruments can be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider</p>   |

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|---|--|
|   | using.   |
| j | <b>Loan capital to local charity</b> – The Council will provide loans to local charities that meets the Council's priorities and can demonstrate that they are sustainable in the medium term and able to meet their repayments as they fall due. Such loans will be for no more than 3 years, and will be closely monitored to ensure any risk of default is minimised. |

**Note 1: This Authority will seek further advice on the appropriateness and associated risks with investments in these categories.**

*The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately and if required new counterparties which meet the criteria will be added to the list.*

## 4 TREASURY MANAGEMENT SCHEME OF DELEGATION

### 4.1 Full Council

- Receiving and reviewing reports on treasury management policies, practices and activities;
- Approval of annual strategy.

### 4.2 Cabinet

- Approval of / amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- Budget consideration and approval;
- Approval of the division of responsibilities;
- Receiving and reviewing regular monitoring reports and acting on recommendations;
- Approving the selection of external service providers and agreeing terms of appointment.

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## 4.3 Audit Committee

- Reviewing the treasury management policy and procedures and making recommendations to the responsible body.

## 5 THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

### The S151 (responsible) officer

- Recommending treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- Submitting regular treasury management policy reports;
- Submitting budgets and budget variations;
- Receiving and reviewing management information reports;
- Reviewing the performance of the treasury management function;
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- Ensuring the adequacy of internal audit, and liaising with external audit;
- Recommending the appointment of external service providers.
- Preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe.
- Ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- Ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- Ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- Ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- Ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- Provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- Ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- Ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- Creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following: -
  - Risk management, including investment and risk management criteria for any material non-treasury investment portfolios;

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- Performance measurement and management, including methodology and criteria for assessing the performance and success of non-treasury investments;
- Decision making, governance and organisation, including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
- Reporting and management information, including where and how often monitoring reports are taken;
- Training and qualifications, including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.