Committee:	**Cabinet**	**Agenda Item**
Date:	**10 December 2015**	**9**
Title:	**Treasury Management Benchmarking**	
Portfolio Holder:	**Councillor Simon Howell**	Key decision: **No**

Summary

1. Treasury Management is the activity of the Council's finance function which manages cash flows, bank accounts, deposits, investments and borrowing. The objective is to manage risk effectively in order to ensure the security of funds, sufficient liquidity to enable commitments to be met, to generate income and minimise cost.

2. The Council has been extremely cautious with its lending policy over the last few years and consequently has had minimal investment return.

3. At the Cabinet Committee meeting on 22 October 2015 members requested a report comparing the treasury management activities of other Councils, in particular Councils within Essex. Due to difficulty in obtaining the latest treasury management activities of each authority within the region it was not possible to produce a detailed benchmarking exercise of authorities in Essex.

4. However the Council's treasury consultant, Arlingclose, produces a quarterly benchmarking exercise which could assist UDC to compare the Council's activities to the average treasury activities of Councils across the country.

5. The investment benchmarking exercise included in the body of this report is based on data supplied by clients of Arlingclose, which includes some Essex authorities but not all of them as they are not all Arlingclose clients.

6. The report covers all investments made for treasury purposes, including external funds, but excludes any investments made for service purposes. As part of this exercise it defines external funds as those pooled investment funds where the client has delegated investment decisions to a fund manager, other than instant access to Money Market Funds (MMF). All other investments are classed as internal investment. External funds include investments such as the Churches, Charities and Local Authorities (CCLA) property fund which is utilised by Councils seeking a higher return compared to fixed term deposits if it was invested for more than a year.

    - MMF - are short term liquidity pooled fund investments. Each investor who invests in a money market fund is considered a shareholder of the investment pool, a part owner of the fund. The most important characteristic of a money market fund is the highly diversified and high credit quality investments within the fund.

    - CCLA - is a Public Sector Deposit Fund managing investments for charities, religious organisations and the public sector. The fund mainly invests in Fixed Terms Deposits and call accounts. Although the deposit fund invests in fixed term investments, due to the larger scale of these investments a higher rate of return is achieved and this is shared accordingly between all members.

7. The average authority invests more of its total investments in Money Market Funds and Call Accounts compared to UDC.

8. Furthermore the exercise does provide evidence that the Council can potentially increase its rate of return on investments without increasing its exposure of risk.

Recommendation

9. It is recommended that the 2016/17 Treasury Management Strategy is prepared with the aim of ensuring an improved rate of return is achieved whilst acknowledging the risk appetite of the council.

Financial Implications

10. Included in the body of the report.

Impact

Communication/Consultation	None
Community Safety	None
Equalities	None
Health and Safety	None
Human Rights/Legal Implications	None
Sustainability	None
Ward-specific impacts	None
Workforce/Workplace	None

Background

11. Treasury management is defined as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."
External Context

UK Economy:

12. **Credit outlook:** The varying fortunes of different parts of the global economy are reflected in market indicators of credit risk. UK Banks operating in the Far East and parts of mainland Europe have seen their perceived risk increase, while those with a more domestic focus continue to show improvement. The sale of most of the government's stake in Lloyds and the first sale of its shares in RBS have generally been seen as credit positive.

13. Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the UK, USA and Germany. The rest of the European Union will follow suit in January 2016, while Australia, Canada and Switzerland are well advanced with their own plans. Meanwhile, changes to the UK Financial Services Compensation Scheme and similar European schemes in July 2015 mean that most private sector investors are now partially or fully exempt from contributing to a bail-in. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain stubbornly low.

14. **Interest rate forecast:** The Authority's treasury advisor Arlingclose projects the first 0.25% increase in UK Bank Rate in the third quarter of 2016, rising by 0.5% a year thereafter, finally settling between 2% and 3% in several years' time. Persistently low inflation, subdued global growth and potential concerns over the UK's position in Europe mean that the risks to this forecast are weighted towards the downside.

Investments

15. The latest approved counterparty category list for investment purposes in 2015/16 is summarised as follows and depending on which category the counterparty falls under it is subject to limits listed below and in addition is subject to limits set by Arlingclose.

General Counterparty list *	Credit Rating	Cash limit	Time limit
Banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	£2m	365 days
	AA+	£2m	365 days
	AA	£2m	365 days
	AA	£2m	365 days
	AA-	£2m	365 days
	A+	£2m	182 days
	A	£2m	182 days
	A-	£2m	182 days
	BBB+	£1m	100 days
Council's General bank acount if it fails to meet the above criteria, excluding fixed term deposit accounts		£1.5m	next day
UK Central Government (irrespective of credit rating)	AA+	unlimited	50 years
UK Local Authorities including Fire and Police (irrespective of credit rating), per authority	N/A	£3m	182 days
UK Building Societies without credit ratings	N/A	£1m	100 days
Saffron Building Society	N/A	£0.5m	100 days
Money Market Funds, UK Domiciled per fund	AAA	£1m	next day

* This list is the maximum risk appetite the Council is willing to take and is within the limit set by Arlingclose Counterparty list. Furthermore UDC does not exceed the cash, credit rating and time limit set by Arlingclose in their regularly updated counterparty report

16. In 2014/15 the Council, with a similar counterparty list as above, achieved an average return of 0.32% (£80,700 in income) for its investments.

UDC performance in the first 6 months of 2015/16 compared to the average Arlingclose client

17. The charts in the Appendices A-E are a snapshot of investments held on the last working day of the quarter for clients of Arlingclose and compares UDC performance against other authorities.

18. The reported levels of risk and return will differ according to clients' average risk and return for the quarter. The September 2015 benchmarking covers data from 123 local authority clients of Arlingclose but for some charts it only compares UDC's performance against similar authorities.

19. **Rate of Return on Total Investment Portfolio (Appendix A):**

    The chart in Appendix A highlights that most of the Arlingclose clients (123) receive an investment rate of return much higher than Uttlesford DC. There are at least 28 authorities who receive an average rate of return above 1% and more than 70% of the clients receive a rate of return above 0.50% which highlights that there is some scope for UDC to investigate ways to improve the rate of return achieved.

20. **Average Rate vs Credit Risk (Appendix B)**

    The chart in Appendix B compares UDC to the average English Non-Metropolitan Districts (approx. 50) and compares the risk appetite against the average rate of return. The top left corner in the chart indicates a good performance. The chart indicates that UDC has a lower risk appetite and subsequently achieves a low rate of return. The Council could assess whether to increase its risk appetite and potentially receive a rate of return between 0.5% and 1%.

21. **Investment Instruments – Variance to Average (Appendix C)**

    According to data provided within the investment instrument chart, Appendix C, UDC lends more in fixed term deposits than the average authority reviewed within this exercise. The average authority lends up to 15% to 20% more in Call Accounts and Money Market Funds compared with UDC.

    Fixed term deposits are seen increasingly as more risky as a result of Bail-In risk legislation (see point 13 above).

22. **Country of Investment – Variance to Average (Appendix D)**

    As part of this exercise Money Market Funds are recognised as sovereign portfolio and as shown in Appendix D a large part of the average authority investments are in Money Markey Funds (MMF). The chart displays that the average authority invests around 20% more in MMF than UDC. The average authority invests in more counterparties outside of the UK than UDC.

23. **Counterparty of Investments – Variance to average (Appendix E)**

    The final chart in Appendix E highlights that the average authority invests more in percentage with Santander UK, Standard Chartered, Close Brothers, HSBC, Leeds Building Society and various other banks / building societies including foreign banks compared with UDC. Counterparties like HSBC and Standard Chartered are

reportedly reluctant to borrow from UDC due to the limitations within our current strategy in the value of cash we can lend and the time limits.

Conclusion

24. The data provided by the Council's Treasury consultants shows that UDC's current strategy is more risk averse than the average authority. The treasury management strategy of UDC limits the Council from receiving higher returns and its performance with regards to rate of return is low when compared with other authorities.

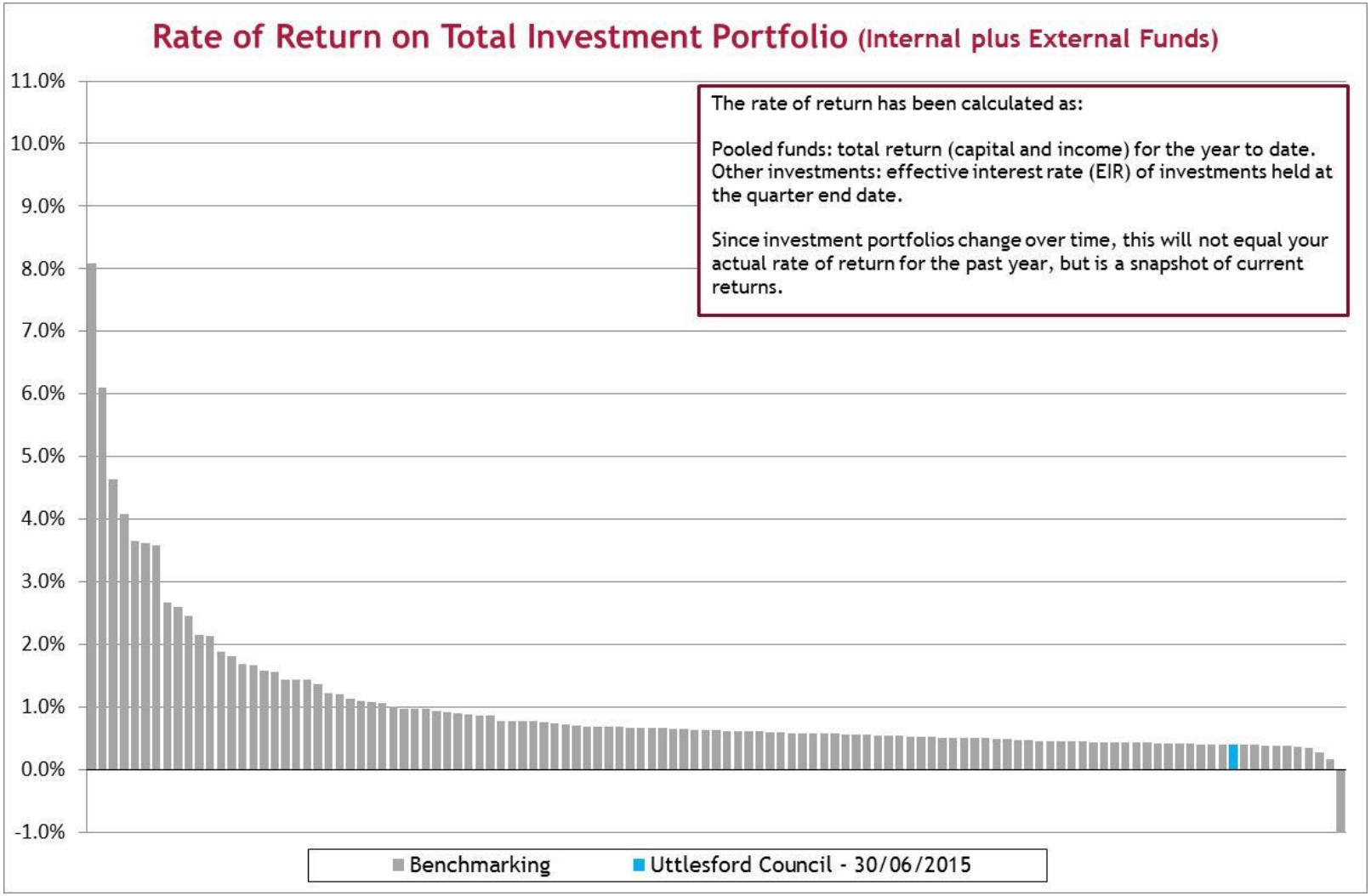
25. The Council invests more in fixed term deposits than the average authority. Whereas the average authority has more funds placed with Money Market Funds and Call-Accounts. The average authority has more counterparties which they invest with compared to UDC, as listed in Appendix E.

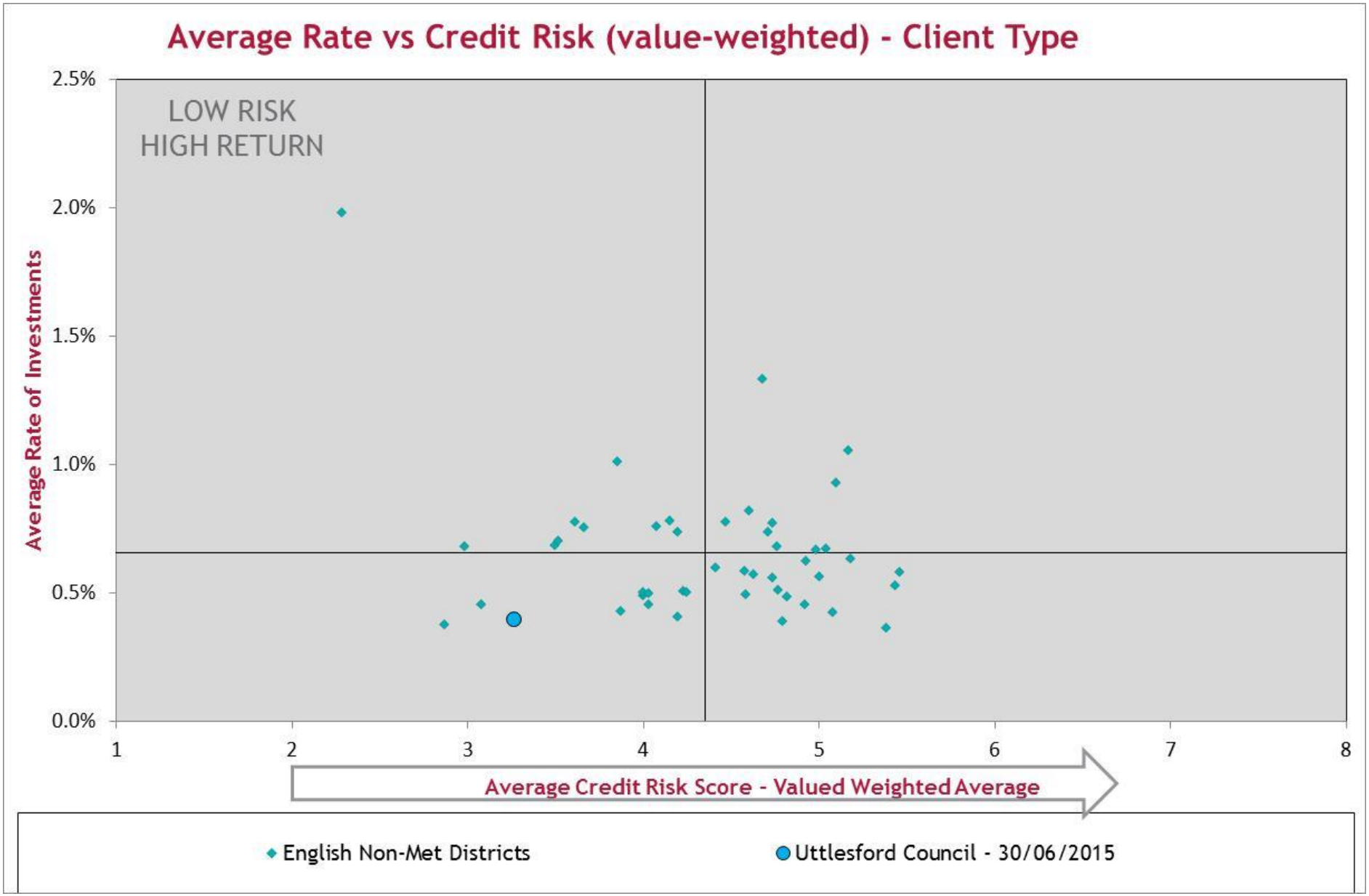
Risk Analysis

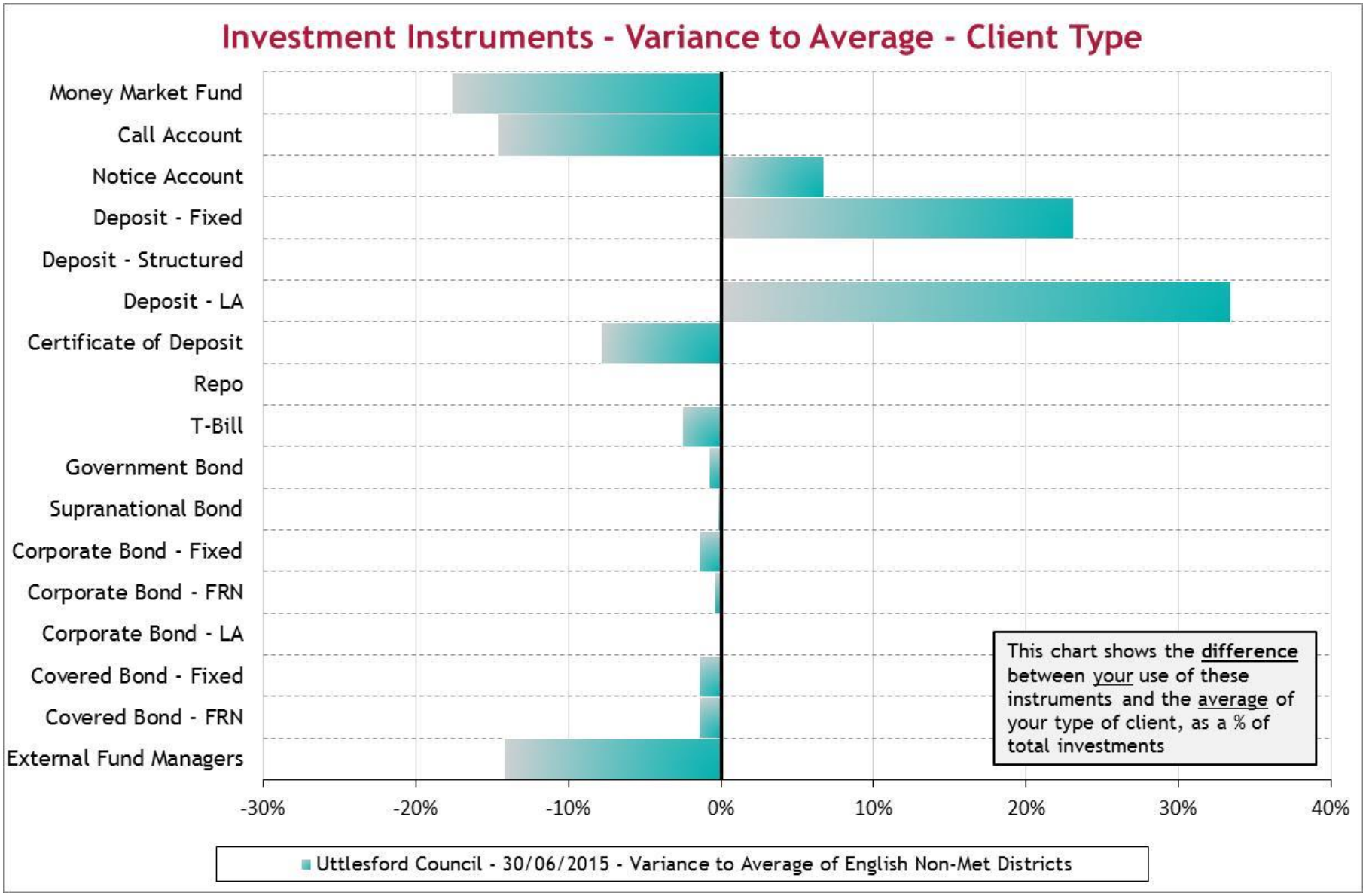
Risk	Likelihood	Impact	Mitigating actions
Loss of Council funds through failure of banking counterparty	2 (minimal risk due to nature of institutions used)	4 (significant sums are placed on deposit)	Treasury Management Strategy and regular monitoring with independent advice from Arlingclose Treasury consultants.

1 = Little or no risk or impact
2 = Some risk or impact – action may be necessary.
3 = Significant risk or impact – action required
4 = Near certainty of risk occurring, catastrophic effect or failure of project.

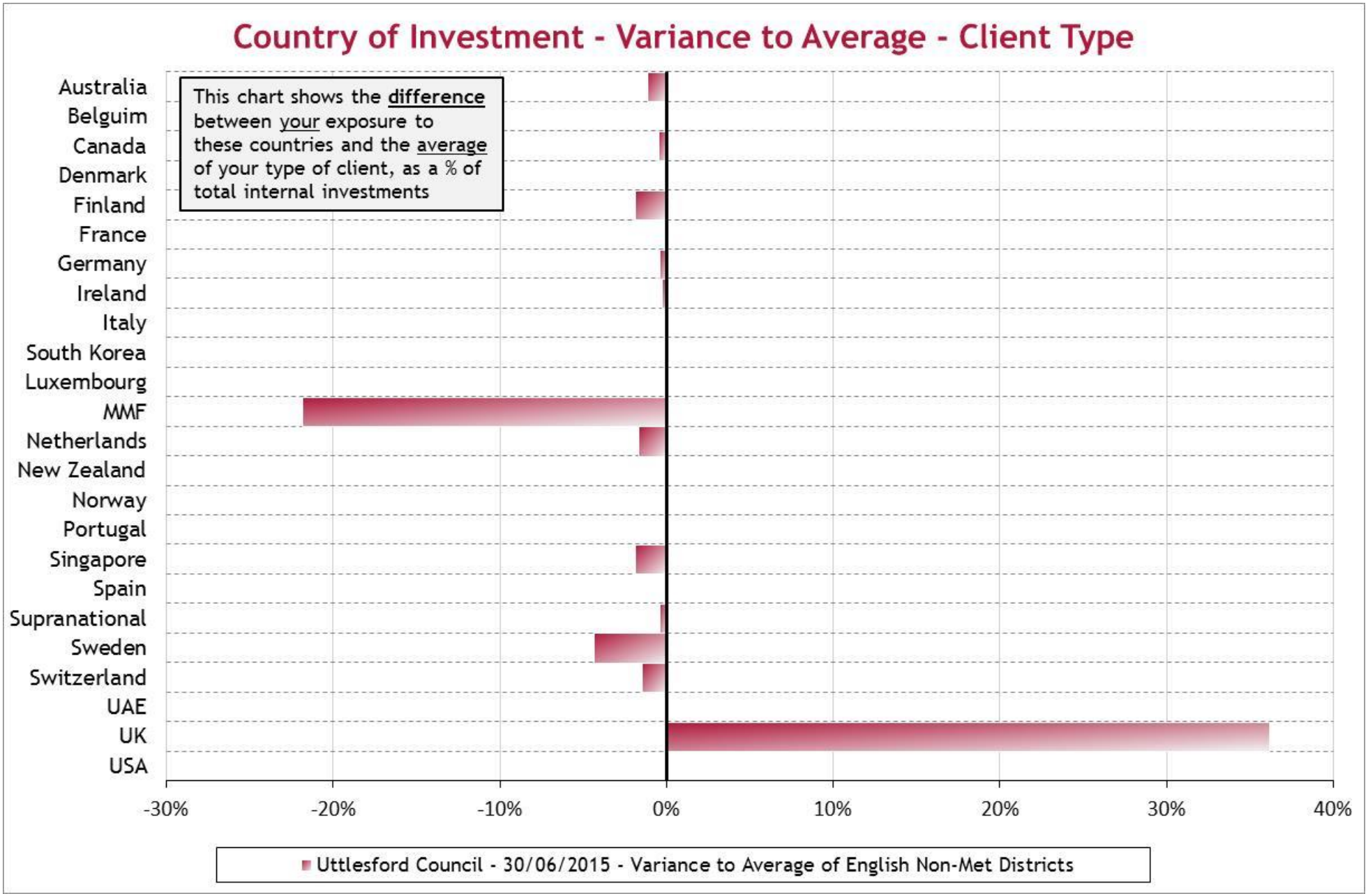
APPENDIX A

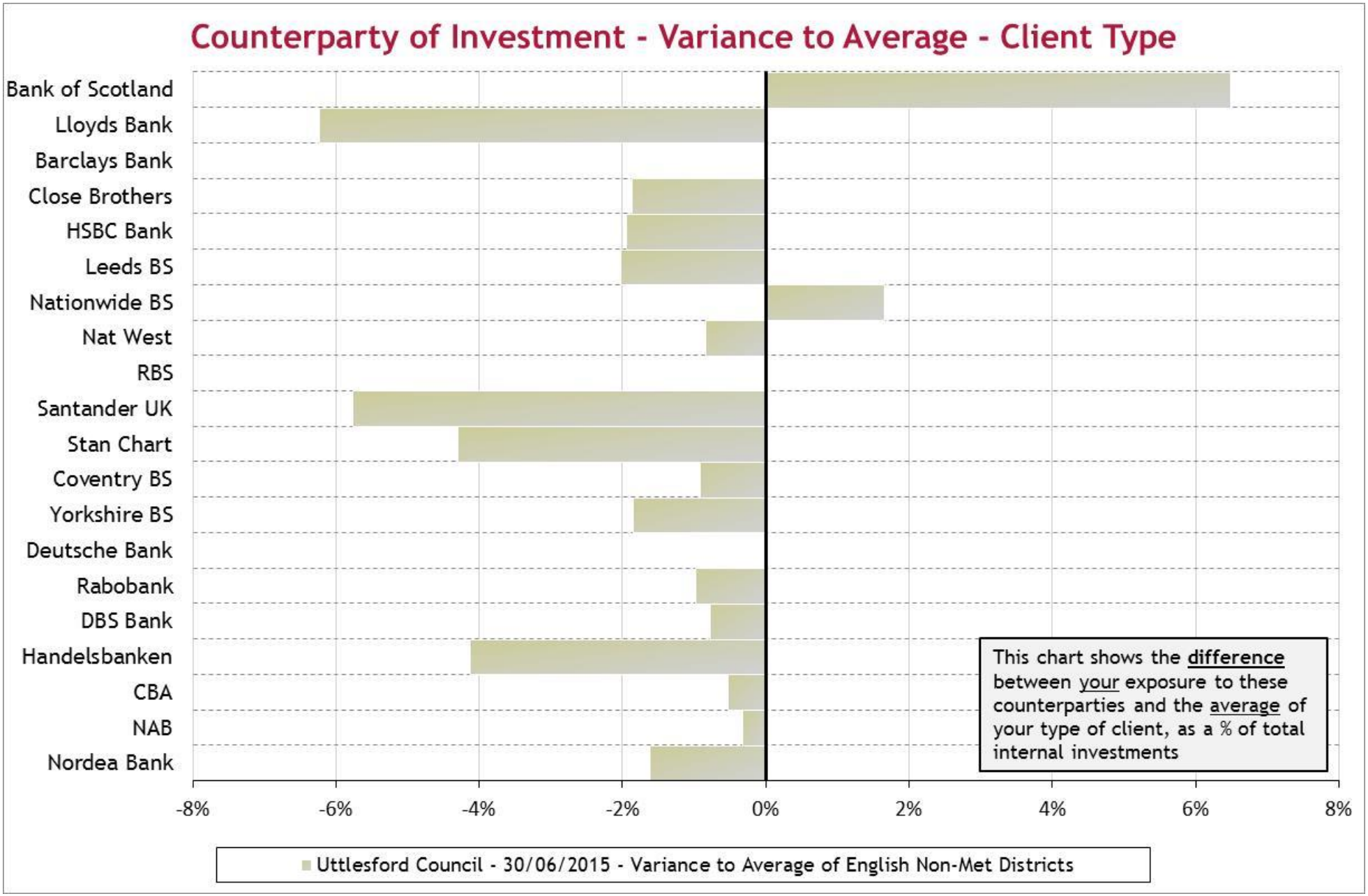

Rate of Return on Total Investment Portfolio (Internal plus External Funds)
11.0%
10.0%
9.0%
8.0%
7.0%
6.0%
5.0%
4.0%
3.0%
2.0%
1.0%
0.0%
-1.0%
The rate of return has been calculated as:
Pooled funds: total return (capital and income) for the year to date.
Other investments: effective interest rate (EIR) of investments held at the quarter end date.
Since investment portfolios change over time, this will not equal your actual rate of return for the past year, but is a snapshot of current returns.
Benchmarking
Uttlesford Council - 30/06/2015


Average Rate vs Credit Risk (value-weighted) - Client Type
LOW RISK
HIGH RETURN
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
Average Rate of Investments
1
2
3
4
5
6
7
8
Average Credit Risk Score - Valued Weighted Average
English Non-Met Districts
Uttlesford Council - 30/06/2015


Investment Instruments - Variance to Average - Client Type
Money Market Fund
Call Account
Notice Account
Deposit - Fixed
Deposit - Structured
Deposit - LA
Certificate of Deposit
Repo
T-Bill
Government Bond
Supranational Bond
Corporate Bond - Fixed
Corporate Bond - FRN
Corporate Bond - LA
Covered Bond - Fixed
Covered Bond - FRN
External Fund Managers
-30%
-20%
-10%
0%
10%
20%
30%
40%
This chart shows the difference between your use of these instruments and the average of your type of client, as a % of total investments
Uttlesford Council - 30/06/2015 - Variance to Average of English Non-Met Districts

APPENDIX D


Country of Investment - Variance to Average - Client Type
This chart shows the difference between your exposure to these countries and the average of your type of client, as a % of total internal investments
Australia
Belguim
Canada
Denmark
Finland
France
Germany
Ireland
Italy
South Korea
Luxembourg
MMF
Netherlands
New Zealand
Norway
Portugal
Singapore
Spain
Supranational
Sweden
Switzerland
UAE
UK
USA
-30%
-20%
-10%
0%
10%
20%
30%
40%
Uttlesford Council - 30/06/2015 - Variance to Average of English Non-Met Districts


Counterparty of Investment - Variance to Average - Client Type
Bank of Scotland
Lloyds Bank
Barclays Bank
Close Brothers
HSBC Bank
Leeds BS
Nationwide BS
Nat West
RBS
Santander UK
Stan Chart
Coventry BS
Yorkshire BS
Deutsche Bank
Rabobank
DBS Bank
Handelsbanken
CBA
NAB
Nordea Bank
-8%
-6%
-4%
-2%
0%
2%
4%
6%
8%
This chart shows the difference between your exposure to these counterparties and the average of your type of client, as a % of total internal investments
Uttlesford Council - 30/06/2015 - Variance to Average of English Non-Met Districts