AGENDA ITEM:

Council: **10th April 2019**

Report of:	**Borough Treasurer**
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SUBJECT: CASH INVESTMENTS – POTENTIAL RISKS AND REWARDS

Wards affected: Borough Wide

1.0 PURPOSE OF REPORT

1.1 To outline investment alternatives for cash holdings and to detail the associated risks.

2.0 RECOMMENDATIONS

2.1 That the report be noted and that potential options for cash investments be included in the Sustainable Organisation Review that will be reported to the Council meeting in July 2019.

3.0 BACKGROUND

3.1 The Treasury Management and Prudential Indicators Monitoring report 2018-19 was submitted to Council in October 2018. At this meeting it was resolved:

'That a report be presented to Council, no later than April 2019, setting out the potential risks and rewards of accepting less security when investing the Council's cash holdings.'

3.2 It is standard practice that three Treasury Management reports are submitted to Council each financial year:

- A Treasury Management Framework report incorporating Capital Finance submitted to February Council;
- A Treasury Management and Prudential Indicator outturn performance report submitted to July Council;

- A Treasury Management and Prudential Indicator monitoring report submitted to October Council.

3.3 The Treasury Management report that is submitted to February Council contains a number of strategy statements and documents including:

- A Treasury Management Strategy incorporating both investments and borrowing;

- A Minimum Revenue Provision Policy;

- A Capital Strategy.

3.4 Each strategy document is compiled in accordance with the CIPFA Treasury Management Code of Practice. In addition Link Asset Services have been engaged to act as treasury advisors to support the Council's treasury management activities.

3.5 A key cash investment strategy principle that is currently followed is that monies are invested in the money markets based on security, liquidity and yield in that order. This is a low risk approach to cash investments which provides security for taxpayers money but means that investment returns are relatively low, typically around the base interest rate. It is worth noting that as a result of this approach, in contrast to many other local authorities, the Council had no investments in Icelandic banks when they collapsed during the financial crisis of 2008.

3.6 A key borrowing strategy principle that has been used in recent times is to utilise Council cash balances rather than external borrowing to fund asset investments. This approach makes sense at the current time because the rate of return on our cash investments is lower than the cost of external borrowing, and consequently this provides a more attractive financing route.

4.0 POLICY IMPACT AND OUTCOMES

CASH INVESTMENT STRATEGY

4.1 It is anticipated that the Council will have on average in the region of £20m in cash to invest over the course of the 2019-20 financial year and the budgeted investment return from this is some £0.174m. The investment policy means that cash investments are only made in the highest credit rated financial institutions that are British based or in other local authorities. Performance in this area is measured against the 3 month LIBID interest rate.

ASSET INVESTMENT / BORROWING STRATEGY

4.2 The Council has made significant asset investments in recent years as follows:

- Solar Panels	£1.9m
- Greenwood Business Centre	£1.7m
- Wheatsheaf Walk	£3.0m
- Development of the Westec house site	£3.1m

4.3 These schemes have primarily been financed by borrowing with some additional funding coming from Council reserves. For each of those schemes no external borrowing was undertaken to finance them, and internal borrowing through using cash balances has been put in place instead. The schemes that have been completed are all currently generating positive financial returns with lower than expected borrowing costs. Future performance on these schemes will however depend on a range of factors including changing economic conditions. The development of the Westec house site is currently in progress but is expected to deliver a significant capital return.

4.4 Careful consideration will need to be given going forward to the best approach for financing the Skelmersdale Town Centre regeneration scheme, replacement leisure facilities, and the recently approved Development Company.

5.0 ALTERNATIVE INVESTMENT STRATEGIES

5.1 There are a range of alternative investment opportunities that are available including:

- Increasing the maximum level of counterparty investment, which is currently limited to £5m.
- Investing cash sums for longer periods
- Investing in foreign banks / assets
- Property funds
- Money market funds
- Equity funds

5.2 The Council is currently achieving an average rate of return on its cash investments of 0.633%. However within the investment portfolio, the maximum that is being achieved is a rate of 1.1% with the Bank of Scotland. If the maximum counterparty limit of £5m was increased that would enable more money to be invested with the Bank of Scotland at a higher rate. This would however carry a higher counterparty risk because a greater proportion of Council investments would be held with a single institution that could potentially default. However, it would still be with a British bank that is highly credit rated and has a low historic risk of defaulting.

5.3 Currently there are financial institutions that offer rates of some 1% for a 3 month period. When looking at a greater investment period, say up to 1 year then the increase in rates that are on offer only marginally increase, c1–1.2%. Investing funds for longer periods carries an increased risk though that the counterparty may encounter financial difficulties that were not anticipated when the investment was made.

5.4 Considering the rates offered by foreign banks, the differential on offer appears relatively small in most cases at this time within reasonable risk parameters. However, this could be an area that is kept under review to see whether this option may be worth considering in the future. It would however require investment in the treasury management function to ensure there is sufficient expertise to manage these investments effectively.

5.5 The Council could choose to invest in property funds organised through external fund managers. Property funds tend to be longer term in nature but can offer higher rates of return, typical levels being 3% to 4%. The risk associated is that monies may be tied up for longer periods and that returns can fluctuate with the economic conditions of the UK property sector. The risk mitigation factors include, the fact that these funds are run by organisations with a strong track record in this market and therefore have high levels of expertise, and the pooling nature of the funds.

5.6 In a similar vein the Council could use a similar organisation to invest in money market funds (MMFs). The funds are generally considered more secure than property funds and can vary in duration and hence returns. However average returns are typically on a par with many call accounts offered by banks, so when management fees are factored in, they may not be a particularly attractive investment vehicle.

5.7 When considering investment strategies it is also important to consider the future cash flow position of the Council. The Skelmersdale Town Centre redevelopment and Development Company initiatives will have a significant capital financing requirement, and this could be partially met from internal borrowing from cash balances. The difference in interest rates between externally borrowing and internal borrowing from cash balances can be in the order of 2%, and so could be an attractive option.

6.0 SUMMARY AND WAY FORWARD

6.1 The current investment and borrowing strategy that the Council employs has provided security of investment, financial returns and reduced borrowing costs. It has facilitated some ambitious capital schemes that have improved the commercial industrial offer available to the private sector, bought the Council a stake in Ormskirk Town Centre, and contributed to a range of other policy objectives.

6.2 As Members will be aware the Council is currently undertaking a Sustainable Organisation Review and the outcomes of this are set to be reported to Council in July 2019. It is anticipated that this Review will contain a number of potential options in relation to investments for the consideration of Members. It should be noted that any proposed changes would have to be considered in light of the regulations and guidance that cover these activities.

7.0 SUSTAINABILITY IMPLICATIONS

7.1 By having a robust approval and monitoring process, the cash investment strategies that are in place have provided a solid financial basis for providing returns, and facilitating capital schemes that have provided a rate of return, contributed to policy objectives and reduced borrowing costs.

8.0 RISK ASSESSMENT

8.1 The Council is signed up to the CIPFA Treasury Management Code of Practice and Prudential Indicators are reviewed on a regular basis. This helps to minimise the risks associated with financing decisions.

8.2 It is possible to earn a higher rate of return than is currently being achieved through investing in alternative approaches. Typically though these new approaches will have a higher risk associated with them and Members will need to consider their appetite for risk in making future investment decisions.

Background Documents
Treasury Management in the Public Services, Code of Practice and Cross-Sectoral Guidance Notes 2017 Edition.

Equality Impact Assessment
The decision does not have any direct impact on members of the public, employees, elected members and/or stakeholders. Therefore, no Equality impact assessment is required.

Appendices
None