REPORT REFERENCE NO.	**RC/17/9**
MEETING	**RESOURCES COMMITTEE**
DATE OF MEETING	**15 NOVEMBER 2017**
SUBJECT OF REPORT	**TREASURY MANAGEMENT STRATEGY**
LEAD OFFICER	**Director of Finance**
RECOMMENDATIONS	***(a) That the Devon & Somerset Fire & Rescue Authority be recommended to approve an amendment to the Terms of Reference for the Resources Committee as set out within paragraph 6.4 of this report; and*** ***(b) Subject to (a) above, the report be noted.***
EXECUTIVE SUMMARY	The Committee receives quarterly reports on the Authority's Treasury Management performance which has prompted discussion and questions regarding opportunities to expand the Authority's portfolio of investments and the pursuance of an ethical investment strategy. The information contained within this report is intended to provide an overview of the options regarding diversification and ethical investments to inform future review of the Authority's Treasury Management Strategy Statement.
RESOURCE IMPLICATIONS	As indicated in the report.
EQUALITY IMPACT ASSESSMENT	An initial assessment has not identified any equality issues emanating from this report.
APPENDICES	Appendix A – Report from Capita on Ethical Investment Strategies
LIST OF BACKGROUND PAPERS	Treasury Management Strategy (Including Prudential and Treasury Indicators report 2016-17 to 2018-19)

1. INTRODUCTION AND BACKGROUND

1.1 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.”

1.2 The committee receives quarterly reports on the Authority’s Treasury Management performance which has prompted discussion and questions from Members of the Fire & Rescue Authority regarding opportunities to expand the Authority’s portfolio of investments and the pursuance of an ethical investment strategy.

1.3 In particular, officers were asked to research the benefits of diversifying the Authority’s investment portfolio in to both peer to peer lending platforms (such as Funding Circle) and in to property investment portfolios (such as CCLA).

1.4 Discussions have been held with the Authority’s Treasury Management Adviser, Adam Burleton from Capita, to inform this report and information has been provided by Capita on the risks and benefits of diversification and ethical investment policies.

2. TREASURY MANAGEMENT STRATEGY STATEMENT

2.1 The Authority is required to produce a Treasury Management Strategy and Minimum Revenue Provision Statement which outlines the approach for investments and borrowing for the following three years. The Strategy Statement is prepared according to statutory requirements and the Chartered Institute of Public Financial Accountants (CIPFA) guidance which are detailed in the following paragraphs.

2.2 The Strategy and Minimum Revenue Provision Statement is currently approved by the Full Authority at its February budget setting meeting with the monitoring of Treasury Management Performance being delegated to the Resources Committee.

Statutory requirements

2.3 The Local Government Act 2003 (the Act) and supporting regulations requires the Authority to “have regard to” the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Authority’s capital investment plans are affordable, prudent and sustainable.

2.4 The Act therefore requires the Authority to set out its treasury management strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included as paragraph 3 of this report). This sets out the Authority’s policies for managing its investments and for giving priority to the security and liquidity of those investments.

2.5 The Department for Communities and Local Government issued revised investment guidance which came into force from 1 April 2010. This guidance was captured within the revised CIPFA Treasury Management Code 2011.

CIPFA requirements

2.6 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by the Authority on 19 February 2010. The Code was reissued in 2011 with cross sectorial guidance notes.

2.7 The primary requirements of the Code are as follows:

a. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Authority's treasury management activities;

b. Creation and maintenance of Treasury Management Practices which set out the manner in which the Authority will seek to achieve those policies and objectives;

c. Receipt by the Authority of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a mid-year review report and an annual report (stewardship report) covering activities during the previous year;

d. Delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for this this Authority the delegated body is Resources Committee, and for the execution and administration of treasury management decisions and for this Authority the responsible officer is the Treasurer; and

e. Delegation by the Authority of the role of scrutiny of treasury management strategy and polices to a named body. For this Authority the delegated body is Resources Committee.

2.8 In summary, this Authority has adopted the following reporting arrangements in accordance with the requirements of the Code:

Area of Responsibility	**Authority/ Committee/Officer**	**Frequency**
Treasury Management Policy and Management Practices	Full Authority	Initial adoption in 2010
Revisions to Treasury Management Policy and Management Practices	Full Authority	As and when required (reviewed annually as part of constitutional governance framework review reported to Annual Authority meeting).
Treasury Management Strategy and Minimum Revenue Provision (MRP) Statement	Full Authority	Annual before the start of each financial year
Revisions to Treasury Management Strategy and Minimum Revenue Provision (MRP) Statement	Full Authority	Mid-year
Annual Treasury Outturn Report	Full Authority	Annually by 30 September after the end of the year
Treasury Management Monitoring Reports	Resources Committee	Quarterly

3. **CURRENT INVESTMENT STRATEGY**

3.1 The Treasury Management Strategy and Minimum Revenue Provision Statement approved by the Fire & Rescue Authority on 17 February 2017 (Minute DSFRA/49c refers) outlines the Authority's current investment strategy.

3.2 The Authority will have regard to the Department for Communities and Local Government's Guidance on Local Government Investments ("the Guidance") and the Chartered Institute of Public Financial Accountants (CIPFA) Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code") in setting its Treasury Management Strategy and Minimum Revenue Provision Statement.

3.3 The Authority's current investment priorities are:

- the security of capital; and
- the liquidity of its investments.

3.4 The Authority also aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Authority is low in order to give priority to the security of its investments.

3.5 In accordance with this, the Authority currently uses a portfolio of conventional investments which are:

- Call/ Notice Accounts;
- Term deposits – banks;
- Money Market Funds; and
- Debt Management Account Deposit Facility.

3.6 The Authority's Treasury Management Advisers, Capita, advise us on the creditworthiness of any potential investments and, given the Authority's low risk appetite, only the most secure investments are made. Whilst officers research the marketplace to achieve the best returns possible, priority is given to the security and liquidity of investments, with the majority of cash balances being invested for less than one year.

3.7 The administration of such investments is relatively straight forward and yields are fully understood at the point of investment. Officers do not require a high level of specialist knowledge in order to undertake the investment activity.

4. **DIVERSIFICATION OF THE INVESTMENT PORTFOLIO**

4.1 The Resources Committee broached the idea of pursuing alternative investment strategies at its meeting on 1 September 2017 (Minute * RC/5 refers). The Chief Fire Officer indicated at the meeting that the Service could look into this and report back to the Committee at a future meeting as appropriate.

4.2 The Authority's Treasury Management Adviser, Capita, has provided some advice on the potential alternative investment options that might be available, including Peer to Peer lending and Property Investment Portfolios and further information in respect of the risks and benefits of each of these options is set out in the paragraphs below.

4.3 *Peer to Peer lending platforms (such as Funding Circle)*

Risks	Benefits
• Security of investment – potential investments not credit rated using Capita's modelling approach and there is limited historic information available on which to make an assessment • Fees and charges – returns can be diluted by high fees for investing via the online platform • Returns not guaranteed due to potential bad debts • Liquidity – sale of loan parts is dependent on willing buyers and therefore there might be a delay in return of investment when required • Security of investment – borrowers on peer to peer platforms tend not to have access to traditional financing which might mean that banks have assessed they are not credit worthy • Finance Officers will be required to administer and report on multiple investments which will require additional time	• Greater returns • Opportunity to target investment in local organisations (e.g. South West Region) • Opportunity to target investment in "ethical" companies • Further diversification of investment portfolio would spread risk

4.4 *Property Investment Portfolios*

Risks	Benefits
• Liquidity – property will always be a long term investment option • Liquidity – release of funds from the portfolio may be reliant on the sale of a property or number of properties which can be a slow process • Yield – performance of the portfolio is entirely dependent on the health of the property market • Yield – if a property is empty for some time, rental income will suffer • Security – if a fund is highly geared capital may be at risk in times of volatile market conditions • Forthcoming accounting regulations will require in year profits/ losses to be included in the Authority's revenue account, meaning that budgets will be affected during the year • Local Authority regulations require investment in property to be treated as Capital Expenditure which impacts on the Capital Financing Requirement	• Greater returns • Further diversification of investment portfolio would spread risk • Stability of return via fixed period rents • Property markets are historically profitable over the long term

• Liquidity - any investment in these funds would have a suggested investment horizon of 3 years+. The Fire Authority would need to have sufficient long term cash throughout that period to support the investment • Finance Officers will be required to administer and report on multiple investments which will require additional time	

4.5 As stated in paragraph 3.3 of this report above, the Authority's investment strategy currently gives priority to security and liquidity over return, with a low risk appetite, therefore Peer to Peer Lending Platforms and Property Portfolios do not meet the requirements of the published strategy.

5. ETHICAL INVESTMENT POLICIES

5.1 As outlined above, the Authority's Investment Strategy prioritises investment of cash surpluses on the basis of Security, Liquidity and return and does not make provision for the ethical implications of investment activity. Investments decisions are made based on an approved counterparty list provided by Capita.

5.2 Ethical investment means placing funds and selecting investments in a manner that reflects an authority's ethical values. Generally, two sets of criteria are drawn up – negative and positive values whereby investments are to be avoided or encouraged.

5.3 This is a contentious and subjective area as negative criteria for one authority may be positive for another. For example in an area where jobs and investment are dependent upon a military presence, or the existence of a nuclear power plant, it could be argued that these should be supported by the authority which might conflict with Human Rights or Environmental criteria.

5.4 Appendix A of this report sets out a report by Capita on Ethical Investment and outlines some practical issues regarding the implementation of such policies which include:

- The possibility that investing in an "ethical" institution may result in inter bank lending to an institution which does not meet the criteria
- The lack of diversification in ethical institutions reducing the ability to spread credit risk
- Potential for a conflict between security (credit rating) and ethical criteria requiring prioritisation
- Ethics is not a criteria for consideration under CIPFA and CLG investment guidance
- Whether the views of council tax payers would support the ethical investment policy where it might result in lower financial performance
- Legal issues over balanced decision making.

5.5 The Authority investment strategy gives priority to security and liquidity over return, therefore introducing ethical criteria to investments would not meet the requirements of the published strategy. Were members minded to review the investment strategy of the Authority a more detailed report on risks, benefits and potential returns can be prepared.

6. CONCLUSIONS

6.1 Under the current investment strategy for 2017-18, when making investment decisions, officers must have due regard to the published strategy of prioritising security and liquidity over return on investment, with a low risk appetite.

6.2 Alternative investment options of Peer to Peer lending, Property Portfolios and ethical investments are not compatible with the Authority's current low risk appetite.

6.3 The Resources Committee currently has delegated responsibility only for the scrutiny of treasury management performance. Given previous requests, the Committee may wish to recommend to the Authority that the Committee's Terms of Reference be amended to enable it to consider and make recommendations on the Treasury Management and Investment Strategy and MRP Statement prior to approval by the Authority. The suggested wording for such an amendment is:

"Advisory only:

1. To give preliminary consideration to and recommend to the Authority a provisional budget and Council Tax requirement ***and the Treasury Management and Investment Strategy and MRP Statement*** for the forthcoming year".

6.4 This would give the Committee the ability to review the Strategy each year at the same time as considering the provisional budget (which is a linked issue) and council tax.

6.5 The Committee is therefore invited to consider recommending that the Authority approves the change in the Committee's Terms of Reference as set out within paragraph 5.4 of this report.

AMY WEBB
Director of Finance (Treasurer)

APPENDIX A TO REPORT RC/17/9

REPORT FROM CAPITA ON ETHICAL INVESTMENT POLICIES

CAN A LOCAL AUTHORITY HAVE AN ETHICAL INVESTMENT POLICY?

Many local authorities with responsibilities for pension funds have considered the extent to which ethical investment criteria should influence the placement or withdrawal of investments in shares, bonds and various funds, particularly on a long term basis, to provide for the payment of pensions to future pensioners. Some pension funds have adopted ethical investment criteria.

Some local authorities have also questioned whether ethical criteria could be employed with reference to investing surplus cash balances of the authority itself, though this would be on a much shorter term basis than pension fund investing and typically for periods less than a year. However, there are major difficulties with this and as far as we are aware, no local authority has adopted an ethical investment policy for the placing of surplus cash.

The main obstacles are the obligations on every local authority to: -

a) Implement the CIPFA Code of Practice on Treasury Management
b) Implement investment guidance by the CLG
c) Achieve optimal performance in investment returns.

One key difficulty with ethical investment is that it has potentially as many different definitions as the people who are concerned to raise this issue. In other words, the first step in making an attempt at determining an ethical investment policy is for an authority to provide a CLEAR definition of precisely what it is aiming at and the criteria by which the policy will be put into effect.

What are ethical investments?

Ethical investment means placing funds and selecting investments in a manner that reflects an authority's ethical values. Generally, two sets of criteria are drawn up – negative and positive values whereby investments are to be avoided or encouraged. Examples could therefore be:

Positive	***Negative***
Positive Environmental Policy	Pollution Convictions
Community Involvement	Poor Human Rights Record
Equal Opportunities	Nuclear Power

This is a contentious and subjective area as negative criteria for one authority may be positive for another. For example in an area where jobs and investment are dependant upon a military presence, or the existence of a nuclear power plant, it could be argued that these should be supported by the authority. Alternatively, you could take a line that you should not invest with any UK bank as the UK is one of the biggest arms manufacturers in the world and also one of the biggest users of nuclear power and possessor of nuclear weapons in the world.

Ethical investments for local authority cash surpluses
The topic of ethical investment is very common in the field of pension funds where the fund manager has a very wide range of permitted investments e.g. domestic and international equities, bonds, corporate paper and property, derivatives, unlisted securities, currencies, unit trusts.

Since the advent of new government guidance on investing in 2004, local authorities have had scope to consider as wide a range of potential investments as they consider appropriate with the proper management of risk so as to ensure that council taxpayers do not suffer from adverse performance or actual losses of cash. The most commonly used form of investing is the placing of cash deposits with authorised institutions,

PRACTICAL PROBLEMS TO ADOPTING AN ETHICAL INVESTMENT POLICY FOR CASH SURPLUSES

1. Inter bank lending

It is theoretically possible for an authority to select approved counterparties to place cash deposits with which have a specific policy on ethical investments, assuming of course that both parties have similar views on what is ethically sound. However, it is common practice for banks with cash surpluses to lend to other banks with a cash requirement. Therefore although the authority has placed their funds with an institution that meets its requirements, it is perfectly possible that their funds are being used by another institution for activities that are not approved. Some banks do have policies that prohibit the direct lending of funds to companies and governments of dubious ethical nature yet inter-bank lending does occur and so funds may be utilised indirectly.

2. Diversification

There are very few banks which have a strong ethical stance, the Cooperative Bank being the main one *(October 2013 - though at the time of writing, this bank is facing a major challenge to address a shortfall in capital and there is a question as to whether it has a long term viable future).* Would an authority consider it to be reasonable to have 100% of its risk exposure in the banking sector placed with just one counterparty and also with a counterparty under such severe financial stress? If it was, how would it reconcile this with observing the recommendations of the CIPFA Code of Practice on Treasury Management to avoid over concentration of investments and the general requirement of the Code to ensure proper management of risk by adopting suitable credit criteria to select counterparties with high creditworthiness? The CLG's investment guidance also requires all specified investments to be of high credit quality and if an authority chooses to adopt investment opportunities which do not have that, then these have to be classified as being non specified and their use justified in the annual treasury management strategy report.

3. Use of credit ratings

If the authority found that there are banks which were acceptable to its ethical investment policy, but had credit ratings which clearly warned that investments would not be financially secure if placed with them, which policy would take precedence?

4. Explaining losses on ethical investments to the public

If an ethical policy were to take precedence over the use of credit ratings to choose counterparties with the highest credit worthiness, and an ethical bank were to get into financial trouble which placed the investment at risk, how would the members explain their decision to adopt an ethical investment policy to council tax payers?

5. Optimal investment returns

Authorities are required to achieve best value by implementing CIPFA and CLG investment guidance based around the three principles of security, liquidity and yield (yield being optimal performance once the objectives of security and liquidity have been achieved). The implementation of these principles will be subject to regular inspection by internal and external audit. If a local authority were to receive an adverse audit report on sub optimal investment performance due to adoption of an ethical investment policy, how would members respond to justify such a policy which was non complaint with CIPFA and CLG guidance and which took cash away from being placed with institutions offering higher rates of return than those available from 'ethical' counterparties?

6. Council tax

Would a majority of council tax payers support paying a higher council tax charge due to a poorer return on ethical investments, or a lower level of service if council tax cannot be raised above a set ceiling?

7. Legal issues concerned with placing ethical investments

Every decision taken by an authority should comply with the Wednesbury principles i.e. when making decisions, local authorities should do the following: -

a) Have regard to all relevant matters which the authority is bound to consider.
b) Exclude from its considerations matters which are irrelevant.
c) Not come to a decision that is "so unreasonable that no reasonable authority could have ever come to it."

Authorities therefore owe a duty to the taxpayer to deploy the financial resources available to it to the best advantage – a point made by Lord Diplock in the case of Bromley LBC v Greater London Council (1982). This clearly indicates an obligation to obtain the best possible financial return from investments which may be available, but offers authorities discretion to choose how those investments can be made. An authority, therefore, must not reach an investment decision so unreasonable that no reasonable authority would have made such a decision.

To the best of our current knowledge, no local authority in the UK has adopted an ethical investment policy for its surplus cash balances. Any authority seeking to adopt such a policy would therefore need to address an issue of why it would be the first one.

Capita Asset Services 15.10.13