Financial Scrutiny and Audit Committee
6 March 2018
Agenda Item No 6

Investment Strategy and Performance Report 2017/18
Report by Chief Financial Officer

Summary:	This report sets out details of the Authority's investment of surplus cash, including the investment principles adopted and performance during the ten months to 31 January 2018.
Recommendation:	That the current arrangements regarding the investment of surplus cash are noted.

1. Introduction

1.1. It has previously been agreed that a report on the performance of the Authority's investments will be presented to the Financial Scrutiny and Audit Committee, with a fuller 'year end analysis' at the July meeting, and a mid year progress report at the appropriate half year meeting.

2. Investment Principles and Performance

2.1. The investment of surplus cash is governed by the Authority's Treasury and Annual Investment Strategy 2017/18. Details of this strategy renewal can be found in paragraph 3.1.

2.2. As detailed in the strategy the Authority's primary concern is to safeguard its capital and the liquidity of its investments. Surplus cash sums are monitored on a weekly basis by the Authority's Finance staff and transferred as and when required to appropriate institutions listed in the Strategy. Cash flow requirements can result in transfers in both directions as the year progresses. The key facts for the ten months to 31 January 2018 were:

- Opening balance £2.000 million.
- Closing balance £2.500 million.
- Highest sum £2.500 million.
- Lowest sum £2.000 million.

2.3. There has been one maturity in September of a Fixed Term investment which was reinvested for a further period of one year (£1 million). The Authority also invested in a 90 day notice account in September (£500 thousand) to reduce funds held in the Business Premium Account (instant access). The current portfolio has meant that interest income is forecast to beat previous budget predictions.

2.4. The figures for the previous year (2016/17) were:

- Opening balance £4.250 million.
- Closing balance £2.000 million.
- Highest sum £4.250 million.
- Lowest sum £0.000 million.

2.5. It is important to note that whilst the figures for 2016/17 had larger opening balances this was under the previous arrangement with Broadland District Council. This arrangement meant that any balances held were available on an instant access basis and a transaction charge was made to cover the Council's costs involved in the administration of the investments (including bank charges for direct money transfers). Up until 30 November 2016 the actual interest receivable by the Broads Authority was based on the actual interest received on Broadland's internal investments.

2.6. The sum paid over by Broadland for 2016/17 was £11,776.59 based on internal monthly returns that ranged from 0.031% to 0.047%. Interest earned by the Broads to 31 March 2017 was £2,994.11 based on monthly returns that ranged from 0.013% to 0.083%.

2.7. The total interest earned in 2016/17 was £14,771 which includes the interest from Broadland and other internal investments. Forecast interest for 2017/18 is £20,000.

3. Draft Treasury and Annual Investment Strategy 2018/19

3.1. The Prudential Code requires local authorities to produce an Annual Investment and Capital Financing (borrowing) strategy. This must be approved before the start of each financial year, by the Full Authority.

3.2. A draft can be found in Appendix 1 which incorporates the latest CIPFA guidance from its Treasury Management Code of Practice (2017). The main changes between the draft and the current year's are shown in track changes. The main change relates to the inclusion of non-treasury investments, such as investment properties. Details of which can be found in the Treasury Strategy paragraph 2.5 and the Annual Investment Strategy paragraph 6.

3.3. Members views are sought on the draft prior to the full Authority on 16 March 2018.

Background papers: None

Author: Emma Krelle
Date of report: 14 February 2018

Broads Plan Objectives: None

Appendices: Draft Treasury and Annual Investment Strategy

Treasury Strategy

1. Introduction

1.1. Both CIPFA's Treasury Management Code of Practice (201~~1~~7 Edition) and the Prudential Code requires the Authority to produce a strategy which explains the Authority's borrowing and investment activities and the effective management and control of those risks. This strategy seeks to incorporate the best practice recommendations from this guidance whilst also bearing in mind the Guidance for Smaller Public Service Organisations (2014 Edition).

2. Treasury Management Policy Statement

2.1. The Authority defines its treasury management activities as:

2.1.1. The Management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; the pursuit of optimum performance consistent with those risks and any financial instruments entered into to manage these risks.

2.1.2. The Authority regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

2.1.3. The Authority acknowledges that effective treasury management will provide support towards the achievement of its strategic objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance management techniques, within the context of effective risk management.

2.2. **Borrowing Principles**

2.2.1. The Authority intends to fund all of its capital expenditure from either its earmarked reserves, capital receipts or from its revenue accounts. However if any of those accounts hold insufficient funds borrowing maybe considered.

2.2.2. The Authority currently has one long term loan from the Public Works Loan Board that was utilised to purchase the dredging operation from May Gurney in November 2007 for £290,000. This is to be paid over a 20 year period at a fixed interest rate of 4.82%. Repayments are incorporated into the revenue budget.

2.2.3. The Authority also has the option to enter into finance leases to purchase capital items. Typically this has included the purchase of large pieces of equipment such as the JCB, ~~and~~ the Doosan excavator and the concrete pump. International Financial Reporting Standards include these types of leases as borrowing due to the risk and reward of the asset transferring to the Authority.

2.2.4. If additional borrowing was deemed necessary following committee consultation then the Authority would need to minimise the costs to the revenue budgets including future year repayments and undertake new borrowing at the cheapest cost.

2.3. **Investment Principles**

2.3.1. The Authority's main objective is the prudent investment of its treasury balances. The main priorities are the security of capital and the liquidity of its investments. It will be only after these have been satisfied that it will aim to achieve optimum return on its investments. The Authority will not engage in borrowing purely to invest or to on-lend to make a return. Such activity is considered unlawful.

2.4. **Treasury Management Practices**

2.4.1. Risk Management

2.4.1.1. The Authority adopts a low risk appetite to its treasury management but is not totally risk averse. It will invest with other institutions with appropriate credit ratings rather than just making use of government deposits. If additional borrowing should be required it will seek to borrow on a fixed rate basis to build in assurance for future year liabilities.

2.4.1.2. As part of the Authority's strategic risk register risks are monitored and managed on a regular basis. This includes investment risks. These are reported at least twice a year to the Financial Scrutiny and Audit Committee. Responsible Officers review these throughout the year and are discussed at Management Forum.

2.4.1.3. Risks specific to treasury management include:

2.4.1.3.1. *Credit and Counterparty*

The main objective of the Authority is to secure the principal sum it invests and therefore takes a prudent approach as to whom it invests funds with. This is limited to organisations who meet minimum criteria and is covered in more detail within the investment strategy. The Authority also faces this risk through the default of its debtors. Payment terms are limited to 30 days or where appropriate payment is asked for in advance. Corrective action is taken as required to secure outstanding debts. Bad debts are kept to a minimum.

2.4.1.3.2. *Liquidity*

The Authority will maintain adequate cash balances and borrowing arrangements to enable it to achieve its strategic objectives. The Authority will only borrow in advance of need where there is a clear business case to do so and will only do so for the current capital programme. Debt repayments are included in the annual revenue budget.

2.4.1.3.3. *Interest rate*

The Authority will manage its exposure to fluctuations to interest rate risks in line with its budgets. It will achieve this through the prudent use of its approved instruments, methods and techniques to create stability and certainty of costs and revenues, whilst remaining sufficient flexibility to take advantage of unexpected changes to interest rates. The Authority will limit fixed term deposits to a period of no longer than one year to limit risks to liquidity.

2.4.1.3.4. *Exchange rate*

The Authority will manage its exposure to fluctuations in exchange rates to minimise any impact on its budgeted income/expenditure levels. External advice will be sought to manage this in the most appropriate way as it could have a significant impact; this is particularly important in regards to EU grants.

2.4.1.3.5. *Inflation*

The Authority will keep under review the sensitivity of its treasury assets and liabilities to inflation, and will seek to manage the risk accordingly in the context of the whole Authority's inflation exposures.

~~2.4.1.3.5.~~2.4.1.3.6. *Re-financing*

If the Authority was in a position to re-finance its borrowing it will ensure that such arrangements are negotiated, structured and documented and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or re-financing. These will be competitive and as favourable to the organisation that can be reasonably achieved in the light of market conditions at the time. It will manage its relationships with its counterparties to secure this objective and will avoid the over reliance on any one source of funding if this might jeopardise achievement of the above.

~~2.4.1.3.6.~~2.4.1.3.7. *Legal and regulatory*

The Authority will ensure all of its treasury management activities comply with its statutory powers and regulatory requirements. The Authority recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as reasonable to do so, will seek to minimise any adverse risks.

~~2.4.1.3.7.~~2.4.1.3.8. *Fraud, error and corruption, and contingency management*

The Authority will ensure that it has identified the circumstances which may expose it to the risk of loss through fraud, error or corruption. It will employ suitable systems and procedures to ensure segregation of duties, and will maintain effective contingency management arrangements to do so. In addition the Authority holds Fidelity Guarantee Insurance with Zurich Municipal as part of its overall insurance management arrangements.

~~2.4.1.3.8.~~2.4.1.3.9. *Price*~~*Market*~~

The Authority will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect it~~-~~self from such fluctuations.

2.4.2. Performance Measurement

2.4.2.1. Treasury management will be subject to regular review of its value for money and if other alternative methods of delivery will become more appropriate. The Financial Scrutiny and Audit Committee will receive reports twice a year detailing performance. It will also review the Treasury Strategy prior to the Authority meeting which remains responsible for its adoption. Further details of those performance measures are included within the Investment Strategy.

2.4.3. Decision making and analysis

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2.4.3.1. The Authority will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps have been taken to ensure that all issues relevant to those decisions were taken into account at that time.

2.4.4. Approved Instruments, methods and techniques

2.4.4.1. The Authority will undertake its treasury management activities by employing instruments, methods and techniques as detailed in the Investment Strategy.

2.4.5. Organisation, clarity & segregation of responsibilities, and dealing arrangements

2.4.5.1. In order for there to be effective control and risk management it is essential that there is clear segregation of duties. This will be subject to regular review by Internal Audit as part of its key control test. If at any time there is a lack of resources that does not allow this, it will be reported to the Financial Scrutiny and Audit Committee. Such duties are detailed in the Finance department's job descriptions and are reviewed annually.

2.4.5.2. The ~~Head of Finance~~Chief Financial Officer is responsible for the development of the strategy, whilst cash flow monitoring is undertaken by the Senior Finance Assistant and reviewed by the Financial Accountant. The ~~Head of Finance~~Chief Financial Officer will remain responsible for identifying appropriate counter parties in line with agreed criteria. Funds to be transferred will be carried out by the Senior Finance Assistant and Financial Accountant following approval by the ~~Head of Finance~~Chief Financial Officer. All funds will be automatically transferred back into the Authority's main bank account.

2.4.6. Reporting requirements and management information

2.4.6.1. The ~~Head of Finance~~Chief Financial Officer will prepare regular reports for consideration on the implementation of its policies, decisions taken and transactions executed. The reports will also consider the impact of any changes on the budget or other regulatory, economic and market factors.

2.4.6.2. The Full Authority will receive an annual report on the strategy and the plan for the coming year. The Financial Scrutiny and Audit Committee will review this strategy and receive a mid year review and an annual report on activity over the last year. Any impact on investment income will be reported throughout the year to the Full Authority as part of its Finance Performance and Direction reports.

2.4.7. Budgeting, accounting and audit arrangements

2.4.7.1. The ~~Head of Finance~~Chief Financial Officer will prepare the annual budget which will include the costs of the treasury function as well as the investment income as deemed by statute and regulation. The ~~Head of Finance~~Chief Financial Officer will be responsible for exercising control over these items and will report any changes as required as detailed above.

2.4.8. Cash and cash flow management

2.4.8.1. The ~~Head of Finance~~Chief Financial Officer will be responsible for all monies in the hands of the Authority and will be reviewed for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis to ensure that liquidity risk is monitored. This will be undertaken on a weekly basis by the Senior Finance Assistant and reviewed by the Financial Accountant. This weekly forecast will also look at predictions for the current month. Annual cash flow predictions will be prepared by the ~~Head of Finance~~Chief Financial Officer following preparation of the annual budget.

2.4.9. Money laundering

2.4.9.1. The Authority is aware that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Further details can be found in the Authority's Counter Fraud, Bribery and Corruption policy and its Financial Regulations. Copies are available to all staff on the Intranet.

2.4.10. Training and qualifications

2.4.10.1. The Authority recognises the importance of ensuring that all staff involved in the treasury management are equipped to undertake the duties and responsibilities allocated to them. Recruitment of vacant posts will reflect this position and training opportunities will be identified through the annual Individual Performance Review (IPR).

2.4.10.2. The ~~Head of Finance~~Chief Financial Officer will ensure that the Financial Scrutiny and Audit Committee who have treasury management/scrutiny responsibilities have access to training relevant to their needs and responsibilities.

2.4.11. Use of External providers

2.4.11.1. The Authority recognises that responsibility for treasury management decisions remain with the Authority at all times. It recognises that there may be value in employing external providers in order to access specialist skills and resources. However the use of external providers is not currently used based on the Authority's limited amount of surplus funds and the costs associated. If this position changed it would ensure a full evaluation had been undertaken as to the costs and benefits through the Authority's Standing Orders.

2.4.12. Corporate Governance

2.4.12.1. Treasury Management activities will be undertaken with openness and transparency, honesty, integrity and accountability. This together with the other arrangements detailed in the Investment Strategy are considered vital to the achievement of proper corporate governance in treasury management. The ~~Head of Finance~~Chief Financial Officer will monitor and report upon the effectiveness of these arrangements.

2.5. Management Practices for Non-Treasury Investments

2.5.1. The Authority recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.

~~2.4.12.1.~~2.5.2. The Authority will ensure that all investments are covered in the investment strategy, and will set out, where relevant, the Authority's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that for treasury management. A schedule of these types of investments will be included.

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Annual Investment Strategy 201~~7~~8/1~~8~~9

1. This strategy builds on those principles and practices as laid out in the Treasury Management Strategy. It continues to give priority to the security of capital and liquidity before returns are considered.

   1.1. The Authority will continue to invest in Sterling.

2. Specified Investment

   2.1. These investments are made in Sterling and have a duration of 1 year or less. Typically these are low risk investments due to being made with high credit rating bodies, examples include:

   - UK government or local authorities;
   - UK/European banks and building societies
   - Money Market funds (AAA rated by credit rating agency)
   - Debt Management Agency deposit facility

   2.1.1. This list is not exhaustive but highlights where the Authority is most likely to place its funds.

   2.1.2. To mitigate against the risks of credit and counterparty the Authority will only seek investments with bodies that have at least a short term rating of F-1 as stated by Fitch credit ratings.

   2.1.3. The Authority will monitor these ratings monthly through online credit watches and use these to determine any new investments. This may mean those failing to meet the criteria will be removed from the list, whilst those new counterparties who do may be added. Other market information including the financial press will be monitored.

3. Non Specified Investments

   3.1. These investments tend to be any other type of permitted investment which have durations of more than a year. This also includes equity-type investments. At this point the Authority does not consider these types of investments as appropriate but may do so in the future if surplus funds permit.

   3.2. Longer term investments will only be considered with those institutions that have a Fitch credit rating of A (+/-).

   3.3. The Authority will seek proper advice and will consider that advice when entering into arrangements on derivatives to ensure that it fully understands those products.

4. Liquidity

   4.1. The Authority will seek to spread its investments to avoid over reliance on one institution. This is currently split between the Authority's current account provider (Barclays) and fixed term deposits with Lloyds. Funds held at Barclays are automatically swept each day into its Business Premium Account that pays a small amount of interest. This facility is instant access. Based on its cash flow forecasts the Authority anticipates that it's cash balances will range between £2.5m and £4m.

   4.2. Current Holdings as at ~~03~~19/0~~3~~2/18~~7~~

Counterparty	Holding/Investment	Interest Rate	Investment Date	Maturity Date
Lloyds Fixed Term	1,000,000	1%	01/03/17	28/02/18
Lloyds Fixed Term	1,000,000	0.65%	0~~1~~5/0~~3~~9/1~~7~~8	~~31~~04/0~~8~~9/1~~7~~8
Barclays Notice Account	500,000	Base rate +	95 days notice	

Comment [EK1]: Plan to reinvest for 1 year, verbal update to be provided at meeting

		0.25%	
Barclays Premium Account	1,46~~2~~2,000	0.~~15~~4%	Instant access

5. **Capital Financing (Borrowing) Principles**

5.1. The following table shows the current forecast for capital expenditure for the next three years. Commentary is also provided below.

Prudential indicator	201~~7~~8/1~~8~~9	201~~8~~9/~~19~~20	2020~~19~~/2~~0~~1
Estimate of capital expenditure	£200,000	£200,000	£200,000
Authorised limit for external debt	£500,000	£500,000	£500,000
Operational Boundary	£400,000	£400,000	£400,000

5.2. The use of reserves to finance capital expenditure will have an impact on level of investments. However budgeted contributions to earmarked reserves should mitigate this as well as the sale of assets. The table below shows estimates of year end balances for each resource.

Estimated Year-End reserves	201~~7~~8/1~~8~~9	201~~8~~9/~~19~~20	20~~19~~20/2~~0~~1
General and Navigation Reserves	£1,~~3~~250~~7~~,000	£1,2~~93~~27,000	£1,2~~43~~54,000
Earmarked reserves	£1,~~2~~665~~3~~,000	£1,~~5~~944~~0~~,000	£~~1~~2,~~737~~290,000
Total Investments 31 March	£2,~~5~~9~~0~~15,000	£3~~2~~,171~~833~~,000	£~~2~~3,~~980~~544,000

5.3. Affordability

*5.3.1.*The prudential code indicator for affordability asks the Authority to estimate the ratio of financing costs to net revenue stream. However as the only current borrowing was to finance the acquisition of the dredging operation from May Gurney, the financing costs have a zero effect on the bottom line of navigation income and expenditure as the dredging operation (financing costs and ongoing running cost including any additional capital expenditure) are less than or equal to the cost paid to contract out to May Gurney in the past. It is therefore felt that this indicator is not appropriate for use by the Authority in this instance.

5.4. External Debt

*5.4.1.*Prudential indicators in respect of external debt must be set and revised taking into account their affordability. It is through this means that the objective of ensuring that external debt is kept within sustainable, prudent limits is addressed year on year.

*5.4.2.*Therefore, the Authority will at this time only borrow to finance the capital expenditure incurred on the acquisition of the dredging operation from May Gurney.

5.5. Authorised limit

*5.5.1.*The Authority will set for the forthcoming financial year and the following two financial years an authorised limit for its total external debt, separately identifying borrowing from other long term liabilities (excluding pension liability and government grants deferred). It should be noted that the Authority does not have any other long term liabilities at present or plans to have any in the future. This prudential indicator is referred to as the authorised limit and is shown in the table above.

5.6. Operational Boundary

5.6.1. The Authority will set for the forthcoming financial year and the following two financial years an operational boundary for its total external debt. This Prudential indicator is referred to as the operational boundary and is shown in the table above. The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst case, scenario.

5.7. Capital expenditure

5.7.1. The Authority will make reasonable estimates of the total of capital expenditure that it plans to incur during the forthcoming financial year and at least the following two financial years. This Prudential indicator will be referred to as estimate of capital expenditure and is included in the table above.

5.8. Treasury Management

5.8.1. The Prudential Code requires authorities to set upper limits for it exposure to the effects of changes in interest rates. However, as explained above under paragraph 5.3.1, the current borrowing costs will be not be an additional cost to the Authority. The Authority has borrowed at a fixed interest rate, thus reducing its exposure to changes in interest rates. This Prudential indicator is therefore not considered necessary in this instance.

5.8.2. There remains a small risk to the Authority in using fixed term deposits that interest rates may increase in the short term. However given the historic low interest rates on offer following the financial crisis any increase in rates is likely to be slow. By minimising fixed term deposits to a minimum of 1 year and staggering them it will allow the Authority to take advantage of any increase as funds become available for re-investment. Funds in instant access will be able to take advantage of any increase in rates.

5.9. Maturity structure of borrowing

5.9.1. The Prudential Code requires authorities to set upper and lower limits with respect to the maturity structure of its borrowing. However as the Authority only has a single loan this indicator is not considered relevant.

6. **Non-Treasury Investments**

6.1. The schedule below provides details of the non-treasury investments the Authority currently holds:

Classification	**Investment**	**Details**
Investment Property	Ludham Fieldbase	Previously an operational base which was reclassified following reorganisation in 2013. Subsequently held to achieve rental income which has seen limited success following the specialist nature of the property and its location. This has led to the Authority agreeing to dispose of the property and holding it for sale.

~~6.~~ 7. **End of Year Investment and Capital Financing Report**

~~6.1.~~ 7.1. The Authority will provide a report on its investments and capital financing activity at the end of the financial year, as part of its final accounts reporting procedure.

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