TRAFFORD BOROUGH COUNCIL

Report to:	**Executive 29 June 2015** **Accounts & Audit Committee 30 June 2015** **Council Meeting 15 July 2015**
Report for:	**Decision**
Report of:	**The Executive Member for Finance and the Director of Finance**

Treasury Management Strategy: The Local Authority Property Investment Fund

Summary

This report outlines the request for a new investment instrument to be added to those currently permitted to be used as outlined in the Council's Treasury Management Strategy approved 18 February 2015.

The Local Authority Property Investment fund which is managed by the Church Commissioners Local Authority is only available to Local Authorities and the objective of it is to generate long-term growth in the original amount invested whilst generating returns in the form of annual dividends by investing in commercial property throughout the UK.

The inclusion of this instrument would involve the Council placing a proportion of its monies into this fund for a minimum period of 5 years, to improve the potential for an increase in investment income to be generated.

Recommendations

That the Accounts & Audit Committee and Executive recommend to Council the following elements for approval;-

- inclusion of the Local Authorities Property Investment fund into the current Investment strategy,
- maximum duration funds can be placed in an investment instrument be extended from 3 years to 10 years however this extension only applies to monies placed in this fund,
- maximum level of funds to be placed into this fund be set at **£10m**,
- the Prudential indicator for Upper limit for sums invested over 364 days be amended from £60m 2015/16, £60m 2016/17 & £50m 2017/18 to £70m 2015/16, £70m 2016/17 & £60m 2017/18 and a new category be incorporated under the existing Investment criteria as detailed at Appendix A.

Contact person for background papers:
Graham Perkins – Technical Accountant - Extension: 4017

Background papers: None

Relationship to Policy Framework/Corporate Priorities	Value for Money
Financial	The inclusion of this investment instrument to the Investment strategy will aim to increase investment interest generated.
Legal Implications:	Approval is required for the inclusion of this instrument into the current treasury management investment strategy.
Equality/Diversity Implications	Not applicable
Sustainability Implications	Not applicable
Resources Implications e.g. Staffing/ICT/Assets	Not applicable
Risk Management Implications	The monitoring and control of risk underpins all treasury management activities. The Council's in-house treasury management team continually monitor to ensure that the main risks associated with this function of adverse or unforeseen fluctuations in interest rates are avoided and security of capital sums are maintained at all times. This type of instrument is a long term investment so the value of the fund may fall below that invested in adverse market conditions.
Health & Wellbeing Implications	Not applicable
Health and Safety Implications	Not applicable

1. **BACKGROUND**

1.1 The Treasury Management Strategy report approved in February 2015 outlined the investment criteria to be adopted in the forthcoming year. This criteria had been prepared in compliance with regard to the CLG's Guidance on Local Government Investments and the revised CIPFA Treasury Management in Public Services Code of Practice.

1.2 This investment criteria remains as that of previous years i.e. security of capital first, liquidity of its investments and then yield.

1.3 Whilst investment risk cannot entirely be eliminated it can be minimised and in order to ensure that investments are only placed with strong creditworthy institutions, the Council creates a counterparty list based on credit ratings issued by all three of the main rating agencies (Fitch, Moody's and Standard and Poor's).

1.4 Institutions which make up this counterparty list include Banks (UK based & Worldwide), UK Building Societies, UK Local Authorities & UK Money Market Funds.

1.5 Investments are placed into three categories as follows;

- Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.
- Medium-term – cash required to manage the annual seasonal cash flow cycle covering the next 12 months.
- Long-term – cash not required to meet any forthcoming cash flow requirements which can be used primarily to generate investment income after taking into consideration the forecasted interest rate yield curve.

1.6 The use of longer term instruments (greater than one year from inception to repayment) are classified as being Non-specified and funds placed in instruments for this duration will only be undertaken where the Council's liquidity requirements are safeguarded.

1.7 Prudential Indicators limit the amount of funds permissible to be placed in this category is currently set at a maximum level of £60m for investments placed maturing in 1 or 2 years and £50m for 3 years. The Manchester Airport Shares valuation of £36.7m at 31 March 2014 is included within these figures.

1.8 All Investments must be undertaken in Sterling and can be placed in any of the following instruments; however it is only the first two of these which are currently used:

Term Deposits
Money Market Funds
Treasury Bills
Gilts
Certificates of Deposits
Supranational bonds
Multilateral development bank bonds
Government bonds
Share capital or loan capital

1.9 Currently the Council has £99.4m invested with 13 institutions attracting an average rate of return of 0.70% (as at 18 May 2015) and of which £94.4m will mature at various times throughout the next 12 months and £5m in August 2016.

2 LOCAL AUTHORITY PROPERTY FUND

2.1 This fund is aimed solely for use by public sector organisations (Parish Councils through to County Councils) wishing to invest in the property market whilst at the same time generating a favourable rate of return than that achieved from cash deposits.

2.2 The fund currently has approximately 109 clients and has grown from £75m to £387m since 2013 and a breakdown of authorities is shown below for reference;

Value of original investment	Type of Investor
Under £1m	48 Councils – 1 London Borough, 1 Borough Council, 2 District Councils, 25 Town Councils & 16 Parish Councils, 2 Association of Local Councils & 1 Community Council.
£1m to £5m	30 Councils – 2 County Councils, 1 London Borough, 10 Borough Councils, 4 City Council, 11 District Councils, 1 Fire Authority & 1 Police Authority.
£5m+	31 Councils – 8 County Councils, 3 London Borough, 12 Borough Councils, 4 City Council & 4District Councils.

2.3 A major advantage of the Fund is that, unlike other property investments, it does not need to be accounted for in the capital programme. If it was treated as capital expenditure this would require the use of capital receipts or other resources to be matched against the investment. This distinction is permitted by Statutory Instrument (SI 2010 No. 454 paragraph 25(3)d) and the trustee of the fund is LAMIT (The Local Authorities Mutual Investment Trust).

2.4 The Local Authorities Mutual Investment Trust is a company incorporated under the Companies Act 1948 which is controlled by representatives of the Local Government Association, the Convention of Scottish Local Authorities, the Northern Ireland Local Government Officers Superannuation Committee and investors in the Fund and its responsibilities include the approval of the property investment strategy, monitoring the diversification, suitability and risk profile of the Fund's investments, reviewing the performance and expenditure of the Fund and approving the payment of dividends.

2.5 Whilst LAMIT are the appointed trustees of the fund, Church Commissioners Local Authority, CCLA, are the appointed fund managers and they provide administrative and registrar services for the fund as well as company secretarial services to the trustees. CCLA has over 50 years of investment management experience and manage assets of more than £5.0 billion on behalf of its charity, church and public sector clients.

2.6 The fund operates on a monthly dealing basis enabling clients to invest and withdraw funds on a specific date each month, typically being the last working day. As property is an illiquid asset, a minimum lead in time of approximately 2 to 6 months is ideally required to enable the fund managers to acquire / dispose of a property or another Local Authority is found which wishes to sell / purchase a stake in the fund. During this lead in time however, the price of the fund will continue to be subject to market movements which will affect the eventual purchase and selling prices.

2.7 Once funds have been placed in the fund (minimum amount required is £25k – no maximum stipulated) this can be topped up at any time with future investments (minimum amount required is £10k).

2.8 As with any money market transaction, the fund operates on an Offer price (purchase) and Bid price (selling) basis and this reflects the costs of dealing in the fund i.e. stamp duty, Agents fees, Legal fees etc. On any day the Offer price will always be higher than the Bid price and therefore any potential investment in the fund will immediately appear to be a loss. For reference purposes, as at 31 May 2015, the Offer price was 296.35p per unit with the Bid price being 275.90p per unit giving a spread in prices of 7.4%. If, as expected, the fund grows the Offer price will also grow and over a period of time its value should exceed that of originally paid thereby generating a favourable return. Hence the reason for this type of transaction to be regarded as a long term investment.

2.9 Currently the fund's portfolio is made up of Shopping units (9%), Retail warehouses (21%), Offices (41%) and Industrial units (29%) and these are located throughout the country.

2.10 Interest earned on this fund is variable and is currently 4.5% net of fees (0.65%) and is received quarterly net of admin fees; as a comparison, current market interest rates for a 5 yr cash deposit is approximately 2%.

2.11 Capital growth of the fund did suffer in 2008 & 2009 seeing valuations fall by -25% & -3% respectively, however since then it has seen a resurgence in performance achieving over the last 5 years growth, for the year ending 31 March respectively of, 12.1% (2011), 6.0% (2012), 3.7% (2013), 14.3% (2014) & 17.8% (2015). Throughout all of this time however annual dividend returns of approximately 4.5% - 5.0% (net of fees) has been achieved.

2.12 Like with any investment there are no guarantees that the original amount of investment placed will be repaid in full and whilst the fund could generate a more favourable return when sold, it could also produce a loss if the property market encounters difficulties and the selling price goes below the original purchase price.

3 ACCOUNTING

3.1 The International Accounting Standards Board has completed the final element of its comprehensive response to the financial crisis with the publication of the International Financial Reporting Standards, IFRS, 9 on Financial Instruments with an effective date of 1 January 2018. The implementation of this could impact on Local Authorities holding investments that are classified within the Available for Sale category which this type of investment would be. It is currently proposed that any variation in prices in the value of the fund will have to be taken in full to the Council's Income and Expenditure account as they arise and whilst there may be exemptions to this, it is currently not clear what these will include. CIPFA /LASAAC are currently working with HM Treasury to consider the impact of implementation of this standard will have on Local Authorities.

4. CONCLUSION

4.1 The need to look at alternative investment instruments to that traditionally used has arisen due to the number of high quality banks actively seeking cash is reducing and interest rates are expected to remain low for the foreseeable future.

4.2 Whilst one option to overcome this scenario would be to reduce the Council's minimum credit rating criteria thereby enabling funds to be placed in institutions paying better rates of interest, this course of action however would lead to an exposure to higher levels of credit risk.

4.3 Another option would be to increase the total amount which is permissible to be placed with any institution but this again would generate an increase in credit risk exposure at a time when Governments throughout the world are withdrawing support for banks.

4.4 It is proposed, subject to Member approving the addition of this instrument to those currently permitted to be used as outlined at paragraph 1.8, that £5m would initially be placed into this fund. This would permit the performance of the fund to be monitored before committing to any further investments being placed into it.

4.5 By adopting this course of action it would;

- ease the pressure of having to find suitable institutions contained on the Council's approved list who would take its cash and which was not already up to its maximum limit of funds able to be placed with it and
- anticipate a boost to its income generated from investments.

5 RECOMMENDATIONS

5.1 That the Accounts & Audit Committee and Executive recommend to Council the following elements for approval;-

- inclusion of the Local Authority Property Investment fund into the current Investment strategy,
- maximum duration funds can be placed in an investment instrument be extended from 3 years to 10 years however this extension only applies to funds placed in this fund,
- maximum level of funds to be placed into this fund be set at **£10m**, Prudential indicator for Upper limit for sums invested over 364 days be amended from £60m 2015/16, £60m 2016/17 & £50m 2017/18 to £70m 2015/16, £70m 2016/17 & £60m 2017/18 and a new category be incorporated under the existing Investment criteria as detailed at Appendix A.

Other Options

This report has been produced in order to comply with Financial Regulations and relevant legislation.

Consultation

Advice has been obtained from Capita, the Council's external advisors.

Reasons for Recommendation

The report has been produced in order to meet the requirements of the Council's Financial Procedure Rules which incorporate the requirements of both the CIPFA Prudential Code and the CIPFA Treasury Management Code.

Finance Officer Clearance *…GB…*

Legal Officer Clearance ....JL.....

Director of Finance Signature …………

Appendix A

PRUDENTIAL LIMITS & INVESTMENT CRITERIA

In accordance with CLG Guidance, the CIPFA Prudential Code and the CIPFA Code of Practice on Treasury Management each council is required to set, before the commencement of each financial year, Treasury Management Prudential Indicators and limits, a Minimum Revenue Provision Statement and Investment criteria. For 2015/16 these were approved by Council at its meeting on 18 February 2015 however in response to this request the following Prudential Indicators and Investment criteria have been revised.

The Accounts and Audit Committee and Executive are requested to recommend that Council approve these amendments to these limits and criteria for the period 2015/16 – 2017/18 as detailed below.

Prudential Limits

Upper Limit for Sums invested for over 364 days

	2015/16	2016/17	2017/18
Current limit	**£60m**	**£60m**	**£50m**
Revised Limits	**£70m**	**£70m**	**£60m**
– these limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment.			

Investment Criteria

Counterparty Selection

The current minimum criteria for providing a list of high quality investment counterparties is highlighted in the categories below and this is applied to all the Council's investments, a new category, (5) is now requested to be included incorporating the Local Authority Property Investment fund as highlighted below;

	Fitch (or equivalent) – Long Term	Maximum Group Limit	Maximum Time Limit
Category 1 – All UK or Non UK banks and building societies domiciled in a non-UK country which has a minimum Sovereign long term rating of AA and individual credit rating issued by Fitch, Moody's and Standard and Poor's of: • Short Term – Fitch F1 or equivalent • Long Term – Fitch A- or	AA- To AAA A- to A+	£20m £5m	3yrs 1yr

equivalent			
Category 2 – UK Banks part nationalised - Lloyds Bank and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in category1 above.	-	£20m	1yr
Category 3 – The Council's own banker if the bank falls below the above criteria for transactional purposes only.	-	n/a	1day
Category 4 – • Money Market Funds – must be AAA credit rated • Enhanced Money Market Funds – must be AAA credit rated • UK Government (including treasury bills, gilts and the DMO) • Local Authorities • Supranational Institutions • Corporate bonds (Manchester International Airport only)	-	£20m	3yrs
NEW Category 5 – Local Authority Property Investment fund	-	£10m	10yrs