

North Somerset Council

Report to the Audit Committee

Date of Meeting: 28 January 2021

Subject of Report: Treasury management risk workshop

Town or Parish:

Officer/Member Presenting: Steve Ballard

Key Decision: N/A

Reason: Not an Executive decision

Recommendations

The Audit Committee is requested to **note**:

1. the key messages from the treasury management member training workshop held on 13 January 2021,
2. that Members recognised that the Council's treasury management team would continue to work within the Council's current Treasury Management Strategy, and accepted that it provides sufficient flexibility to allow investment opportunities to be considered, whilst providing sufficient mitigation of risk,
3. that information supporting the investment strategy will be subject to on-going review, by officers and members, supported by the Council's treasury management advisors.

1. Summary of Report

- 1.1. The purpose of this report is to note the key messages arising from the treasury management member training workshop, jointly provided and facilitated by Finance Officers and Arlingclose, the Council's treasury management advisors, to members of the Audit Committee on 15 January 2020, and to summarise discussions relating to the preparation of the Strategy for 2020/21.

2. Policy

- 2.1. The Council's Treasury Management and Capital Strategies link directly into its revenue and capital budget planning processes, and seek to identify and manage associated risks and optimise financial opportunities.

3. Details

- 3.1. Audit Committee members attended a training workshop on 'Treasury management risk' on 13 January 2021. The workshop was also attended by the Council's treasury management advisors, Arlingclose.

3.2. The objectives of the workshop were:

- to build on previous Member training and discussions
- to support Members in their role of providing scrutiny of the Council's treasury management activities
- to provide Members with an understanding of the key risks associated with the Council's Treasury Management Strategy, and
- to seek feedback from Members on the appropriateness of the current Treasury Management Strategy, the balance of risk and return being achieved, and the Council's future appetite for risk, to inform development of the Treasury Management strategy for 2021/22.

3.3. The content of the presentation, attached at Appendix 2, was:

- an overview of treasury management
- the role of full Council and the Executive in approving the Treasury management strategy
- how Audit Committee Members provide scrutiny of treasury management arrangements
- the content to the Council's Treasury Management Strategy
- the different types of treasury management risks, their likely impact, and the mitigating arrangements put in place through the Council's Treasury Management Strategy
- Arlingclose's overview of the economic outlook, including forecasts for inflation and interest rates
- an overview of investment management, including investment management objectives – security, liquidity, then yield, and the choices available between risk and return
- Arlingclose benchmarking the Council's investment portfolio, including mix of investment types and the level of investment returns achieved
- Arlingclose benchmarking of the sources of borrowing used by the Council, and
- an overview of the options for sources of future borrowing.

3.4. Members discussed issues arising during the presentation with officers and the Arlingclose team, notably:

- Treasury management risk register – A copy of the latest Treasury Management risk register was included in the presentation. Members asked about the arrangements for update and review of the Treasury management risk register.
- Treasury management risks – The presentation included details of the range of treasury management risks that the Council is exposed to, and the mitigating arrangements maintained by the Council to mitigate these risks. Members discussed the various risks and mitigating arrangements. Treasury management risks discussed included:
 - Credit risk
 - Liquidity risk
 - Interest rate risk
 - Inflation risk
 - Regulatory and political risk

For information, details of the limits included in the Treasury Management Strategy in relation to Credit risk as included at Appendix 1.

- Risk appetite – Discussions with Arlingclose indicated that the Council currently has a relatively low level of risk in its Treasury management portfolio, when compared to other authorities. Members expressed understanding of the reduced returns available in current market conditions, but there was no call to increase the level of risk in the Council's investment portfolio in order to increase returns. Members recognised that the Council's treasury management team would continue to work within the Council's current Treasury Management Strategy, and accepted that it provides sufficient flexibility to allow investment opportunities to be considered, whilst providing sufficient mitigation of risk.
- Economic outlook – Discussion was focused upon Arlingclose's expectations in this area across the medium term, including the possibility of negative interest rates and what that might mean for the Council. Inflation risk was also discussed and officers agreed that the current Strategy effectively mitigated this risk although Council's exposure to interest rate risk would be further reviewed and included within performance monitoring arrangements over the course of the next year to ensure that the Council can respond swiftly on an on-going basis.
- Treasury-related investments - Arlingclose provided benchmarking data on the level of investment returns achieved which can be a tool to review performance. This showed that the Council's arrangements for managing its investment portfolio delivered returns in the mid-range when compared to other authorities, although the benchmarking recognised that councils achieving higher returns generally had a higher risk appetite and higher proportions of their investments in pooled funds.
- Pooled fund investments – Details were shared on the Council approach to manage inflation risk within the Strategy, which is largely covered through a spread of investment products including the use of Pooled Funds. The Council has allocated £10m to be held in medium term investments, with the aim of providing a return in excess of inflation. Arlingclose provided data on the performance of these investments and noted that cumulative returns to date have recovered the loss in capital value arising due to the initial bid/offer spread, and the recent impact of Covid. Members indicated that they were satisfied that the Council's strategy of retaining these investments in the medium term was achieving its objectives.
- Non-treasury commercial investments – Members were advised that non-treasury investments are included within the scope of Treasury Management reporting (as that is a requirement under the Code), although the Council's Constitution allocates responsibility for the strategic oversight of commercial investment decision-making to the Property Infrastructure Board (PIB), with the scrutiny role to the Community and Corporate Organisation Policy and Scrutiny Panel (CoCo). Audit Committee Members review the internal control framework supporting such commercial investments.
- Since 2018 the Council entered into two long-term non-treasury investments, with the objective of acquiring assets that would increase in value and also deliver annual returns into the revenue budget. Monitoring shows that in the period 2018-2020 financial returns were delivered in line with business cases although the

market value of these assets has fallen. The annual returns for North Worle in the current financial year have continued to be positive although the Sovereign Centre returns are below budget. Members discussed the way forward and were advised that a new business plan for the Sovereign Centre is due to be presented to the Executive in February 2021 which is fully integrated and aligned with the Weston Town Centre place-making strategy. Any developments will be included in Treasury Management reports to the Audit Committee.

- Borrowing – Members discussed the recent reduction in the PWLB interest rates, and the pros and cons of the available sources of borrowing. Officers highlighted that the need and timing of future borrowing remains uncertain as the capital strategy is developed, and agreed that before future borrowing is undertaken, officers would seek advice from the Treasury management advisor in relation to the potential costs of different options.
- Borrowing for yield – Past commercial investment property investment was funded through borrowing or finance leases, only after a robust business case was agreed providing a return above the cost of the investment. The government has now amended PWLB regulations to prevent councils using PWLB borrowing to finance property purchases for yield / income generation, rather than operational objectives. There are currently no plans to undertake further borrowing from other sources to finance investments with the aim to provide income generation.

3.5. Key outcomes / actions agreed during the workshop were:

- that the Audit Committee is requested to note the key messages from the Treasury Management Member training workshop held on 15 January 2020,
- that members recognised that the Council's treasury management team would continue to work within the Council's current Treasury Management Strategy, and accepted that it provides sufficient flexibility to allow investment opportunities to be considered, whilst providing sufficient mitigation of risk,
- that the investment strategy, will be subject to on-going review, by officers and Members, supported by the Council's treasury management advisors.

4. Consultation

N/A

5. Financial Implications

5.1. Treasury management decisions, taken through the application of the Treasury Management Strategy, impact on both the revenue budget and the balance sheet in current and future years. Details of the financial implications of treasury management activities are included in the papers presented to the Executive

6. Legal Powers and Implications

6.1. Under the Local Government Act 2003, the Council may invest money or borrow money:

- for any purpose relevant to its functions, and
- for prudent financial management.

6.2. The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017

Edition (the CIPFA Code) which requires it to approve a treasury management strategy before the start of each financial year.

6.3. The Treasury management Strategy is due to be presented to the Council's Executive at their February meeting. They will be requested to recommend approval of the Strategy by full Council.

6.4. The role of the Audit Committee in relation to Treasury Management is to:

- review the Council's arrangements for managing risk and maintaining an effective control environment
- receive and review reports:
 - Performance reports e.g. quarterly
 - Audit reports, acting on recommendations
- Challenge officers where appropriate

7. Climate Change and Environmental Implications

7.1. The impact of the Council's Treasury Management Strategy on Climate change and environmental implications was not directly discussed in the workshop, although it is a consideration within the proposed Strategy.

8. Risk Management

8.1. As noted above, the identification and mitigation of the risks associated with the Council's treasury management activities was central to the workshop presentation, and discussions between members, officers and the Council's treasury management advisors, Arlingclose.

8.2. The workshop included consideration of the arrangements to maintain the Council's Treasury Management risk register.

9. Equality Implications

9.1. None

10. Corporate Implications

10.1. The Council's Treasury management function operates within the Corporate Finance team.

10.2. The safeguarding of public money is critical to the Council's reputation, and the on-going development of the Council's Treasury Management Strategy is intended to address member and public concerns, and ensure an appropriate balance of return on investment whilst ensuring managing associated risks.

11. Options Considered

11.1. The workshop included discussion of the members' views on the Council's appetite for risk, which influences the development of the Council's Treasury Management Strategy, and subsequently the investment options open to officers.

11.2. As noted in the Key outcomes above, members agreed for the Council's treasury management team to continue to work within the Council's current Treasury Management Strategy, as it provides sufficient flexibility to allow investment opportunities to be considered, whilst providing mitigation of risk.

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Appendices:

Appendix 1 – Treasury management strategy criteria and limits

Appendix 2 – Treasury Management risk workshop presentation slides

Background Papers:

Treasury Management Strategy 2020/21

Treasury Management risk register

Guidance:

CIPFA – The Prudential Code for Capital Finance in Local Authorities 2018

MHCLG – Statutory Guidance on Local Government Investments (3rd edition) 2018

CIPFA – Treasury Management in Public Services – Code of Practice and cross-sectoral guidance notes 2017

CIPFA - Treasury Management in Public Services – Guidance notes for local authorities 2018

Appendix 1

Treasury management strategy criteria and limits

The Council minimises its exposure to credit risk through diversification, through the application of limits on the amount and period of its investments with individual counterparties, and in individual countries. The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

	Overall Limit ¹	In-house Limit	Tradition Limit	Time Limit
Banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's and Standard and Poor's is:				
AAA	£30m	£30m	£0m	5 years
AA+	£25m	£25m	£0m	5 years
AA	£22m	£22m	£0m	4 years
AA-	£20m	£16m	£4m	3 years
A+	£18m	£14m	£4m	2 years
A	£16m	£12m	£4m	13 months
A-	£13m	£9m	£4m	6 months
The Council's Bank accounts	Net £9m	Net £9m	£0m	No limit
UK building societies whose lowest long-term rating is BBB and societies without credit ratings, that have an asset size of more than £0.4bn	£10m	£6m	£4m	6 months
UK building societies whose lowest long-term rating is BBB and societies without credit ratings, that have an asset size of more than £1bn	£10m	£6m	£4m	2 year
Money market funds ² and similar pooled vehicles whose lowest published credit rating is AAA	£15m	£15m	£0m	1 year
UK Central Government	no limit	unlimited	unlimited	no limit
UK Local Authorities ³	£15m	£10m	£5m	25 years
Pooled Investment funds	£5m per Fund Type	£5m per Fund type	£0m	N/A

¹ limits shown are per organisation

² as defined in the Local Authorities (Capital Finance and Accounting) Regulations 2003

³ as defined in the Local Government Act 2003

Appendix 2 - Treasury Management risk workshop presentation slides

Attached separately