

POLICY AND RESOURCES COMMITTEE MEETING

Date: Wednesday 20 January 2021

Time: 6.30 pm

Venue: Remote Meeting: The public proceedings of the meeting will be broadcast live and recorded for playback on the Maidstone Borough Council Website

Membership:

Councillors Brice, M Burton, Chappell-Tay, Clark, Cox (Chairman), English, Mrs Gooch, Harvey, McKay, Mortimer, Newton, Perry (Vice-Chairman), Round, Springett and de Wiggondene-Sheppard

The Chairman will assume that all Members will read the reports before attending the meeting. Officers are asked to assume the same when introducing reports.

AMENDED AGENDA

Page No.

1. Apologies for Absence
2. Notification of Substitute Members
3. Urgent Items
4. Notification of Visiting Members
5. Disclosures by Members and Officers
6. Disclosures of Lobbying
7. To consider whether any items should be taken in private because of the possible disclosure of exempt information.
8. Minutes of the Meeting Held on 16 December 2020
9. Presentation of Petitions (if any)
10. Questions and answer session for members of the public (if any)
11. Questions from Members to the Chairman (if any)
12. Committee Work Programme
13. Strategic Plan - Proposed Areas for Focus 2021-2026 and KPIs for Covid19 Recovery

Issued on Wednesday 20 January 2021

Continued Over/:

Alison Broom

Alison Broom, Chief Executive

14. Council Tax Base 2021/22 & Collection Fund Adjustment
15. Medium Term Financial Strategy - Capital Programme
16. MTFS and Budget Proposals
17. Council-Led Garden Community Update

18. **Urgent Item - Treasury Management Strategy - Counterparty Limits**

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INFORMATION FOR THE PUBLIC

In order to ask a question at this remote meeting, please call **01622 602899** or email committee@maidstone.gov.uk by 5 p.m. one clear working day before the meeting (i.e. by 5 p.m. on Monday 18 January 2021).

If your question is accepted, you will be provided with instructions as to how you can access the meeting.

In order to make a statement in relation to an item on the agenda, please call **01622 602899** or email committee@maidstone.gov.uk by 5 p.m. one clear working day before the meeting (i.e. by 5 p.m. on Monday 18 January 2021). You will need to tell us which agenda item you wish to speak on.

If you require this information in an alternative format please contact us, call **01622 602899** or email committee@maidstone.gov.uk.

To find out more about the work of the Committee, please visit www.maidstone.gov.uk.

Agenda Item 18

Policy and Resources Committee

20 January 2021

Treasury Management Strategy – Counterparty Limits

| | |
|---------------------------------------|--|
| Final Decision-Maker | Council |
| Lead Head of Service | Mark Green, Director of Finance and Business Improvement |
| Lead Officer and Report Author | Mark Green, Director of Finance and Business Improvement |
| Classification | Public |
| Wards affected | All |

Executive Summary

The purpose of this report is to address a breach of counterparty limits and recommend adoption of new limits as set out in the proposed 2021/22 Treasury Management Strategy.

Purpose of Report

Decision

This report makes the following recommendations to this Committee:

That Council be recommended to adopt the Treasury Management counterparty limits as set out in Appendix 1 in advance of the previously envisaged adoption date of 1 April 2021.

Timetable

| Meeting | Date |
|--------------------------------|-----------------|
| Policy and Resources Committee | 20 January 2021 |
| Council | 28 January 2021 |

Treasury Management Strategy – Counterparty Limits

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

| Issue | Implications | Sign-off |
|---------------------------------------|--|----------------------------|
| Impact on Corporate Priorities | None | Section 151 Officer |
| Cross Cutting Objectives | None | Section 151 Officer |
| Risk Management | Whilst the financial risks associated with this proposal are considered to be low, we are required by law to operate within the Policy Framework which can only be amended by Council. | Section 151 Officer |
| Financial | Contained within the body of the report – the Treasury management Strategy Counterparty limits are recommended to be amended. | Section 151 Officer |
| Staffing | None | Section 151 Officer |
| Legal | <p>The Council's policy framework includes the Treasury Management Strategy which can only be approved by Council, (Local Authorities (Committee System) (England) Regulations 2012).</p> <p>Exceeding the counterparty limits was unavoidable and there is a risk that the limits may be exceeded again prior to Council meeting on 24 February 2021. In order to mitigate this and bring the Council in line with its policy framework it is therefore a requirement that authority is sought from Council as soon as possible to change the Treasury Management Strategy to bring the issue back in line with the policy framework and prevent future breaches.</p> | Senior Lawyer (Governance) |
| Privacy and Data Protection | None | Section 151 Officer |
| Equalities | None | Section 151 Officer |

| | | |
|---------------------------|------|---------------------|
| Public Health | None | Section 151 Officer |
| Crime and Disorder | None | Section 151 Officer |
| Procurement | None | Section 151 Officer |

2. INTRODUCTION AND BACKGROUND

- 2.1 Attached at Appendix 1 are extracts from the Treasury Management report that went to Audit, Governance and Standards Committee on 18 January 2021.
- 2.2 As part of that report, an increase was proposed to some of the counterparty limits within our current Treasury Management Strategy. The rationale behind this was that over the past financial year the Council's cash balances have, at certain intervals, been significantly higher than anticipated prior to the onset of the Covid 19 pandemic and associated government interventions. The key reasons for this are the up-front payments received for section 31 grants (to compensate for reductions in business rates income payable by ratepayers) and Covid 19 Business Grants which, although only held by the Council for a short time before being paid out to businesses, are significant in terms of value. The proposed changes in counterparty limits are modest and do not significantly increase the Council's risk.
- 2.3 If agreed by AGS committee and full Council on 24th February, the increased limits would have come into effect from 1st April 2021. However, as reported to AGS Committee on 18th January, in advance of the proposed increases in counterparty limits, the Council unavoidably breached some of the limits within the existing strategy. This matter therefore needs to be resolved as soon as possible and an extraordinary Council has been called for this purpose on 28 January 2021.
- 2.4 The breach arises from receipt of the latest tranche of Covid-19 business grants funding, for which £12.4m was received from the government on Friday 15th January. This will shortly be paid over to businesses, but in the meantime the surplus cash has been allocated to counterparties in accordance with the limits proposed within the new strategy, and with reference to existing principles on managing credit and counterparty risk. All investments are held with highly rated institutions and money market funds, with the majority of cash being held in instant access accounts. Details are set out within the table below:

| Accounts | Total Invested | Limit | Breach |
|---|----------------|-------------|-------------|
| Lloyds Bank Plc - Call Account | £5,000,000 | £3,000,000 | £2,000,000 |
| Santander UK Plc - 35 Day Notice Account | £5,000,000 | £3,000,000 | £2,000,000 |
| Handelsbanken AB - Instant Access Account | £5,000,000 | £3,000,000 | £2,000,000 |
| Goldman Sachs MMF | £8,720,000 | £8,000,000 | £720,000 |
| Standard Life MMF | £10,000,000 | £8,000,000 | £2,000,000 |
| Federated MMF | £10,000,000 | £8,000,000 | £2,000,000 |
| Totals | £43,720,000 | £33,000,000 | £10,720,000 |

- 2.5 Officers were made aware on 14th January that payment of this funding would arrive in the Council's bank account on 15th January. As local authorities around the country will have received similar allocations, the scope for short term lending to other councils was extremely limited. Alternative options were to either retain the cash in our current account with Lloyds, or to allocate it to lower rated counterparties. These options were rejected to avoid the over concentration of risk in one area or compromising on the security of our cash deposits.
- 2.6 Cash balances have subsequently reduced at the beginning of week commencing 18th January after payments relating to Covid-19 business grants (£3.7m), housing benefit (£2.1m) and the Kent Business Rates Pool (£5.8m) leave the Council's bank account on Monday and Tuesday. However, whilst balances held with the above counterparties have therefore returned to within the current limits on Tuesday 19th January, the balance with Santander is subject to 35 days notice and will therefore not return within limits until 22 February.
- 2.7 There is also the possibility that limits may be breached again between 15th and 22nd February, following receipt of housing benefit subsidy and further section 31 grant payments.

3. AVAILABLE OPTIONS

- 3.1 The recommendation is made in order to bring the Council in line with its Policy Framework and prevent a future breach of counter party limits.
- 3.2 The only alternative option would be to recommend alternative Counter Party Limits than those proposed to Audit Governance and Standards, but that is not recommend as it goes beyond what is necessary and increases financial risks.

4. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

- 4.1 The preferred option is for Policy and Resources to recommend to Council to amend the counterparty limits in the Treasury Management Strategy in accordance with Appendix 1 as this will mean that the funds are not exceeding the counterparty limits and the Council is operating within its policy framework.
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5. RISK

- 5.1 The financial risks associated with this proposal are considered to be low. The ultimate decision on this matter concerns the Council's Policy Framework which can only be amended by Council.
- 5.2 See Appendix 1 for details of the specific changes in limits and details of measures taken to ensure that counterparties are creditworthy.
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6. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

- 6.1 The Treasury Management issue went to Audit Governance and Standards Committee on 18 January 2021.
-

7. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

- 7.1 The matter will be referred to the Extraordinary meeting of Council on 28 January 2021.
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8. REPORT APPENDICES

Appendix 1: Treasury Management, Investment and Capital Strategies
2021/22

9. BACKGROUND PAPERS

None

Draft Treasury Management Strategy Statement 2021/22

Extracts

4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- "watches" and "outlooks" from credit rating agencies;
- CDS spreads that may give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, and any assigned Watches and Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product of this is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will, therefore, use counterparties within the following durational bands:

- Yellow 5 years *
- Dark pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically, the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of F1 and a long term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap spreads against the iTraxx European Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, as well as information on any external support for banks to help support its decision making process.

| | | | | | | | | |
|------------|------------|------------|------------|-----------|-----------|-------------|---------------|-----------|
| Y | Pi1 | Pi2 | P | B | O | R | G | N/C |
| 1 | 1.25 | 1.5 | 2 | 3 | 4 | 5 | 6 | 7 |
| Up to 5yrs | Up to 5yrs | Up to 5yrs | Up to 2yrs | Up to 1yr | Up to 1yr | Up to 6mths | Up to 100days | No Colour |

| | Colour (and long term rating where applicable) | Money Limit | Transaction limit | Time Limit |
|----------------------------------|--|-----------------------|-------------------|---------------------------|
| Banks * | yellow | £8m | £8m | 5yrs |
| Banks | purple | £7m | £7m | 2 yrs |
| Banks | orange | £5m | £5m | 1 yr |
| Banks – part nationalised | blue | £5m | £5m | 1 yr |
| Banks | red | £5m | £5m | 6 mths |
| Banks | green | £3m | £3m | 100 days |
| Banks | No colour | Not to be used | £0m | |
| Other institutions limit | - | £m | £3m | 5yrs |
| DMADF | UK sovereign rating | unlimited | £5m | 6 months |
| Local authorities | n/a | £8m | £8m | 5yrs |
| Housing associations | Colour bands | £8m | £8m | As per colour band |
| | | | | |

| | Fund rating** | Money Limit | Transaction limit | Time Limit |
|---|-------------------------|--------------------|--------------------------|-------------------|
| Money Market Funds CNAV | AAA | £10m | £10m | liquid |
| Money Market Funds LVNAV | AAA | £10m | £10m | liquid |
| Money Market Funds VNAV | AAA | £10m | £10m | liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.25 | Dark pink / AAA | £8m | £8m | liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.50 | Light pink / AAA | £8m | £8m | liquid |

* Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt –see appendix 5.4.

** Please note: “fund” ratings are different to individual counterparty ratings, coming under either specific “MMF” or “Bond Fund” rating criteria.

Increased Counterparty Limits

The limits stated above have increased from the previous year’s strategy due to the increased funding all local authorities have received from Central Government in respect of COVID-19. There is a delay between receiving funding to making payments to the relevant people eligible which has caused issues with the placement of short term funding. Increasing the limits on money market funds, highly rated banks which are used for instant access/short term notice would help alleviate this issue without the risk of placing funds with a lower rated counterparty or sovereignty.

UK banks – ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

5.4 Credit Limits

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to a maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable. (Non-specified investments which would be specified investments apart from originally being for a period longer than 12 months, will be classified as being specified once the remaining period to maturity falls to under twelve months.)

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the specified investment criteria. A maximum of 25% will be held in aggregate in non-specified investment.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made, it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

| | Minimum credit criteria / colour band | £ limit per institution | Max. maturity period |
|--|--|--------------------------------|------------------------------------|
| DMADF – UK Government | yellow | £8m | 6 months (max. is set by the DMO*) |
| UK Government gilts | yellow | £8m | 5 years |
| UK Government Treasury bills | yellow | £8m | 364 days (max. is set by the DMO*) |
| Bonds issued by multilateral development banks | yellow | £8m | 5 years |
| Money Market Funds CNAV | AAA | £10m | Liquid |
| Money Market Funds LNAV | AAA | £10m | Liquid |
| Money Market Funds VNAV | AAA | £10m | Liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.25 | AAA | £8m | Liquid |

| | | | |
|--|---|-----|---|
| Ultra-Short Dated Bond Funds with a credit score of 1.5 | AAA | £8m | Liquid |
| Local authorities | yellow | £5m | 5 years |
| Term deposits with housing associations | Blue Orange Red Green No Colour | £5m | 12 months 12 months 6 months 100 days Not for use |
| Term deposits with banks and building societies | Blue Orange Red Green No Colour | £5m | 12 months 12 months 6 months 100 days Not for use |
| CDs or corporate bonds with banks and building societies | Blue Orange Red Green No Colour | £5m | 12 months 12 months 6 months 100 days Not for use |
| Gilt funds | UK sovereign rating | £8m | |

* DMO – is the Debt Management Office of H.M.Treasury

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

Use of external fund managers – It is the Council’s policy to use external fund managers for part of its investment portfolio. The fund managers will use both specified and non-specified investment categories, and are contractually committed to keep to the Council’s investment strategy. The fund managers the Council currently engages with are for Money Market Funds and Enhanced Cash Funds.

The Council fully appreciates the importance of monitoring the activity and resultant performance of its appointed external fund manager. In order to aid this assessment, the Council is provided with a suite of regular reporting from its manager.