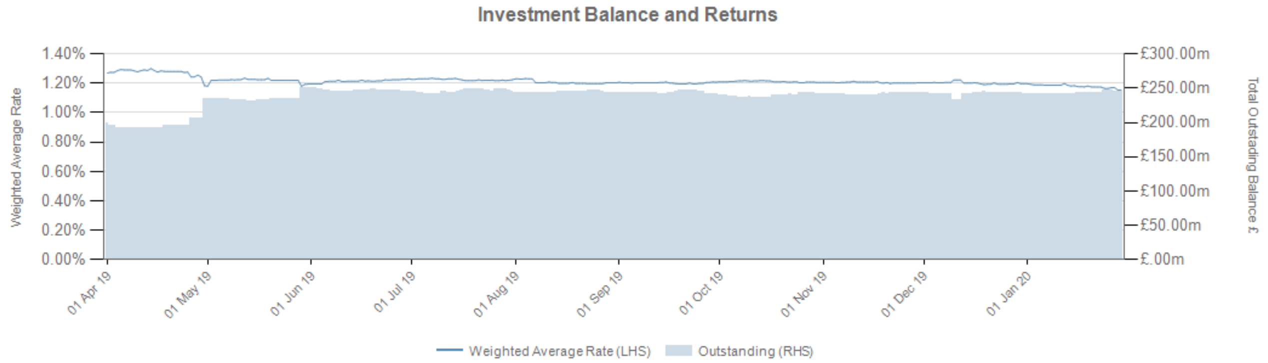
Appendix 1

SHEFFIELD CITY REGION MAYORAL COMBINED AUTHORITY

DRAFT ANNUAL TREASURY MANAGEMENT STRATEGY 2020/21
Investment strategy

Current investment portfolio
The SCR Group has a substantial investment portfolio which has averaged around £240m over the course of the 2019/20 financial year up to and including January 2020 as illustrated below.



At present, there are £60m of long-term investments with the remaining £180m being held in short term investments with a duration of less than one year. The long-term investments are held with stakeholder authorities and are therefore very secure.
A summary analysis of the investment portfolio as at 29 January 2020 by investment type is provided in the table below:

Treasury Investments by investment type	29.1.2020 Actual £'000	29.1 2020 Actual %
Fixed term local authority deposits – held long term with stakeholders	60,000	25
Local authority to local authority market deposits - short term	35,000	14
Call accounts	60,000	25
Money Market Funds - Low Volatility	89,835	36
Total investments	**244,835**	**100**

Short term investment instruments are currently generating a return of c.0.9%.
Long term investments are generating an average return of 2%.
This means that, overall, the average return on investments is c.1.2%

The existing long-term investments will mature over the period from 2020/21 to 2025/26. We will consider with stakeholder authorities at the time that they come up for renewal whether it would be mutually beneficial to reinvest over the long term. The rate of return on any such renewals will depend on the prevailing rates at the time and stakeholder authorities borrowing requirements, i.e. whether they are looking to borrow short term or over the medium to longer term. It may therefore be that the level of such investments may diminish over time offering up the option to invest in other types of long term investment or counterparties.

Coupled with this, the recent bid for Transforming Cities Funding and progress towards unlocking the Devolution Deal will lead to major additional funding streams flowing into the SCR Group which is likely to add substantially to the current size of the investment portfolio.
There is therefore a need for a comprehensive review of the investment strategy to ensure that it is flexible enough to enable a further substantial increase in the level of funds to be managed effectively and to investigate opportunities to diversify the investment portfolio.

Core funds and balances and expectations on returns

Investment decisions are made having regard to the core balance and timings of cash flow requirements and the outlook for interest rates.
Greater returns can typically be obtained by investing for longer periods. However, the value to be obtained from longer term investments will need to be carefully assessed as:

- If it is thought that Bank of England Base Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

<u>Investment returns expectations.</u>
On the assumption that the UK and EU agree a Brexit deal including the terms of trade by the end of 2020 or soon after, then the Bank of England Rate is forecast to increase only slowly over the next few years to reach 1.25% by the first quarter of 2023.

Under this scenario of suppressed returns on short term investments, it makes sense to consider options for investing longer term.

<u>Core funds</u>
There is considerable uncertainty at present, over the level of core funds that will be available to the SCR Group over the medium to longer term. For example, the Government's decision to defer its multi-year settlement Comprehensive Spending Review until 2021/22 means that there is uncertainty over the successor arrangements to the Local Growth Deal and transport capital funding. The timing and/or amount of funding streams associated with the unlocking of the Devolution Deal and recent bid for Transforming Cities Fund has also still to be confirmed along with the profile on how it will be invested.

It has therefore only been possible to conduct an indicative assessment of the level of core funds that might be available over the next 3 years.

However, notwithstanding this, the indications as illustrated in the table below are that cash balances will be of sufficient magnitude to be attractive to financial markets and to therefore investigate options for diversification.

	2019/20	**2020/21**	**2021/22**	**2022/23**
	Forecast	**Indicative**	**Indicative**	**Indicative**
	£'000	**£'000**	**£'000**	**£'000**
Cash backed Reserves and balances - revenue and capital	£99,100	£96,200	£59,400	£55,200
Cash set aside to repay debt	£71,400	£17,200	£13,400	£9,500
Core funds – long term	**£170,500**	**£113,400**	**£72,800**	**£64,700**
Short term cash	£69,500	£41,400	£24,100	£33,600
Total available for investment (short term and long term)	**£240,000**	**£154,800**	**£96,900**	**£98,300**

The short term cash represents unapplied capital grant and working capital which is expected to be required within the next 12 months and can therefore only be invested short term.
The core funds represent cash backed reserves and balances and cash set aside to repay debt representing the underlying level of cash that could be invested longer term.
The reduction in core funds in 2020/21 is due to the fact that £53m of debt is scheduled to be repaid in year as shown in Indicator 7 within Appendix 3.

Indicator 9 - Liquidity: longer term investments of more than 365 days
The table of forecast core funds above provides an indication of the maximum level of investment balances that could be invested longer term.
The SCR Group already has existing long term investments of £60m which will start to mature from 2020/21 onwards.

The table below summarises this position with an indication of the balance available to invest in other long-term investment instruments over the next 3 years if the existing investments were not renewed. The figures for existing long-term investments represents the weighted average balance over the course of the year.

The maximum available is expressed as a percentage of the total estimated investment portfolio in the year including short term cash.

Investment greater than 365 days	2019/20 Forecast £'000	2020/21 Indicative £'000	2021/22 Indicative £'000	2022/23 Indicative £'000
Total core funds - maximum available	£90,000	£113,400	£72,800	£64,700
Existing long-term investments	£60,000	£46,667	£32,833	£17,667
Balance available to invest	£30,000	£66,733	£39,967	£47,033
As a % of total investment portfolio	**37.5%**	**75.0%**	**75.0%**	**65.0%**

Diversification of investment portfolio

As illustrated in the summary of investments by investment type, the current investment portfolio is currently held in a narrow range of investment instruments, namely:

- Deposits with local authorities through the local authority to local authority market
- Call accounts with reputable banks with a high credit rating, and
- Low volatility low risk highly liquid Money Market Funds which provide for instant access.

Typically, deposits with local authorities have a term in the range of 6 to 12 months. Rates are currently in the range 0.85% to 1.10%

The call accounts currently held are 90 to 95 day notice accounts. Rates are currently are around 1% or slightly above.

Money Market Funds provide immediate access and are used to manage day to day liquidity. Rates are currently in the range of 0.70% to 0.75%

The sluggish outlook for economic growth and low inflation rate means that Bank of England base rate rises may not occur for another 12 to 18 months and even then only incrementally by perhaps 0.25%. Accordingly, target returns on short term investments are forecast to rise only slowly from 1% in 2020/21 to 1.5% in 2023/24

The availability of core funds over the longer term and potential non renewal of existing long term investments, provides an opportunity to consider how the investment portfolio might be diversified into new types of longer term investment instrument.

In view of this, preliminary discussions have taken place with the SCR Group's treasury advisors and bankers on other types of medium and longer term investment instrument that the SCR may wish to diversify into.
By way of example, the following is a list of funds that have been discussed with advisors to date. This is not intended to be exhaustive and there are a range of other investment vehicles that could be considered:

- Short dated bond funds (suitable for investors with a minimum time horizon of 2 to 3 years)
- Property Funds (suitable for investors with a minimum time horizon of at least 5 years)
- Multi-asset income funds (suitable for investors with a minimum time horizon of at least 5 years)

These are pooled investment funds where the risk is diversified through the spread of investments. The key is that these investments are more volatile than the more traditional types of investment that the authority has used previously. The volatility of performance lends them to only be appropriate when used in line with the minimum time horizons outlined above. Over the longer term, these investment options have shown that their use can achieve greater levels of return when compared to shorter- term variants. However, there are greater risks associated with their use, therefore MCA approval is sought to delegate authority to the Group Director of Finance to pursue further which new investment instruments should be considered having regard to appropriate professional advice from the external advisors.

Investment policy – management of risk

Statutory guidance issued by MHCLG and CIPFA's Code of practice on Treasury Management places a high priority on the management of risk.
There are two underlying objectives which should underpin an investment strategy:

- Security – protecting the capital sum invested from loss, and
- Liquidity – ensuring the funds invested are available to meet expenditure when needed

The other factor to be taken into consideration is the return on investments or yield. This should be considered having first determined how proper levels of security and liquidity will be obtained.
When entering into new forms of investment, authorities need to consider the balance between security, liquidity and yield based on their risk appetite.

Risk appetite is defined by:

1. Having minimum acceptable **credit criteria** in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings. It should be noted that credit ratings are not the sole determinant of the creditworthiness of a counterparty. The MCA will therefore engage with its external advisors to take account of other information that influences the opinion of the markets.
2. A defined the list of **types of investment instruments** that the treasury management team are authorised to use. These are categorised as 'specified' and 'non-specified' investments.
   - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
   - **Non-specified investments** are those with a duration of more than one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. They can also include investments of weaker credit quality but there is no intention for the MCA to invest in such instruments at present. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.
3. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 75% of the total investment portfolio. This represents the maximum that could potentially be invested in longer term investments with a duration of more than one year as exemplified in Indicator 9. This has been set by reference to forward balance sheet analysis as outlined in the core funds table above and other relevant factors to determine the level of investments that could be invested over a longer period. These

include reasonable projections of the funds that are likely to flow to the MCA once the Devolution Deal has been implemented.

4. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table included in the creditworthiness policy.
5. **Transaction limits** are set for each type of investment in the matrix table included in the creditworthiness policy.
6. The limit for the amount of its investments which are invested for **longer than 365 days**, (see indicator 9).
7. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see creditworthiness policy).
8. All investments will be denominated in **sterling**.

Creditworthiness policy

The MCA has adopted the creditworthiness service provided by its external treasury management advisors to manage counterparty risk.

The service involves a risk weighted scoring of the three main credit rating agencies to arrive at a colour coding system to recommend the maximum duration of investments. This is summarised in the table below:

Colour Band	Duration
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/semi nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 days
No colour	not to be used

The Lending limits, (amounts and duration), for each counterparty have hitherto remained unchanged for several years. This reflects the fact the expected level of investment balances has been largely stable. However, as mentioned previously, there is now a real prospect that the level of expected investment balances may increase materially as a consequence of the additional funding streams that are anticipated from Transforming Cities and unlocking the Devolution Deal.

Accordingly, the Lending limits in the matrix table have been adjusted upwards from last year to take account of these anticipated additional funding streams. However, until clarity over the timing and magnitude of these new funding streams has been obtained, operationally, the MCA will continue to use the lower limits that were used in the 2019/20 annual treasury management strategy. The table below sets out the maximum lending limits should the additional funding streams materialise and operational limits that will continue to apply in the meantime.

At the foot of the matrix table, other investment options have been introduced. These include, for example, short dated bond funds, property funds and multi asset income funds. No limits have been specified for these new investment types as yet, pending further investigation into the options. Delegated authority is therefore sought for the Group Director of Finance to undertake further work with external advisors and the Audit & Standards Committee to consider this further and report back any changes in the mid Year Treasury Report.

	Colour (and long term rating where applicable)	Maximum sum and/or % Limit (per institution)	Operational Limit until new funding streams confirmed	Time Limit
Banks *	**Yellow**	100%	100%	5 years
Banks	**Purple**	£XXm / %	£30m	2 years
Banks	**Orange**	£XXm / %	£30m	1 year
Banks – part nationalised**	**Blue**	£XXm / %	£50m	1 year
Banks (UK Banks)	**Red**	£XXm / %	£20m	6 months
Banks (non-UK Banks)	**Red**	£XXm / %	£15m	6 months
Banks	**Green**	£XXm / %	£10m	100 days
Banks	No colour		Not to be used	
MCA's banker (Barclays) in the event of the bank being 'no colour'	-	£XXm / %	100%	5 days***
DMADF	AAA	100%	100%	6 months
Local authorities and other suitable public bodies or bodies delivering public services funded by the government	N/A	100%	£50m	10 years
Money market funds – CNAV ***	AAA	100%	100%	Liquid
Money market funds – LVNAV ****	AAA	100%	100%	Liquid
Money market funds – VNAV *****	AAA	100%	100%	Liquid
Ultra short dated bond funds with a credit score of 1.25	Dark pink / AAA	100%	100%	Liquid
Ultra short dated bond funds with a credit score of 1.5	Light pink / AAA	100%	100%	Liquid
Short dated bond funds	None	£XXm / %	N/A	3 years
Property Funds	None	£XXm / %	N/A	5 years
Multi Income Asset Funds	None	£XXm / %	N/A	5 years

** Please note: the yellow colour category is for UK Government debt, or its equivalent, constant net asset value money market funds and collateralised deposits where the collateral is UK Government debt.*
*** When placing deposits with part nationalised banks the CA will take care to review when it expects the UK Government to divest its interest in the institution, and the impact this move would have on the CA's view of the institutions security.*
**** to cover period to next working day allowing weekends and bank holidays such as Easter*
***** CNAV refers to Constant Net Asset Value Money Market Funds when investors will be able to purchase and redeem at a constant Net Asset Value(£1 in / £1 out)*
****** LVNAV refers to Low Volatility Net Asset Value Money Market Funds when investors will be able to purchase and redeem at a stable Net Asset Value to two decimal places, provided the fund is managed to certain restrictions*
******* VNAV refers to Variable Net Asset Value Money Market Funds where the price may vary*

The MCA is alerted to changes to ratings through the creditworthiness service provided by its external treasury advisors.
If a downgrade results in the counterparty / investment scheme no longer meeting the MCA's minimum criteria, its further use as a new investment will be withdrawn immediately. Any existing investment will be redeemed as soon as it is economically viable.
Investment instruments identified for use in the financial year are listed under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the MCA's treasury management practices.

Country limits
The MCA has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of “AA-“ from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are as shown below. Should ratings change, this list will be added to, or deducted from, by officers in accordance with this policy.

AAA
- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+
- Finland
- U.S.A.

AA
- Abu Dhabi (UAE)
- France
- Hong Kong
- U.K.

AA-
- Belgium
- Qatar

Specified and Non specified investments
The distinction between specified and non specified investments is important because of the additional procedures that need to be undertaken in considering the risk attached to non specified investments.

Specified Investments
Statutory Guidance on Investments defines specified investments as ones having the following characteristics:
- Denominated in sterling
- The duration is 12 months or less
- The investment is high quality or is with the UK Government or a local authority

High quality is determined by reference to the matrix table included in the creditworthiness policy.
The limits on specified investments are listed in the table below:

	Minimum credit criteria / colour band	** Max % of total investments / £ limit per institution	Max. maturity period
Money Market Funds CNAV	AAA	100%	Liquid
Money Market Funds LNVAV	AAA	100%	Liquid
Money Market Funds VNAV	AAA	100%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	AAA	100%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA	100%	Liquid
Local authorities	yellow	100%	12 months
Term deposits with banks and building societies or housing associations	Blue Orange Red Green No Colour	As per lending limits table	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	As per lending limits table	12 months 12 months 6 months 100 days Not for use
UK government debt	Yellow	100%	12 months

<u>Non specified investments</u>
These are any investments which do not meet the specified investment criteria.
As far as the MCA is concerned, Non-specified investments represent those with a duration of more than one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

There is a wide range of potential investment instruments that could be invested in which by their nature do not fall into the category of a specified investment as they have a duration of more than year or are more complex in nature. The table below illustrates the types of non specified investment that are currently being invested in or are under consideration. The list is not however intended to be exhaustive and may be expanded as other types of investment are investigated.

Duration of more than one year	* Minimum Credit Criteria	** Max % of total investments	Max. maturity period
Term deposits – local authorities	N/A	100%	10 years
Term deposits – banks and building societies	Purple	£30m	2 years
UK Government Debt	Yellow	100%	5 years
Multi asset income funds	** state alternative to credit criteria (following comprehensive fund manager selection process)*		5 years
Property Funds	** state alternative to credit criteria (following comprehensive fund manager selection process)*		5 years
Short dated bond funds	** state alternative to credit criteria (following comprehensive fund manager selection process)*		3 years

Benchmarks for security, liquidity and yield

Security
The risk of default varies according to the type of investment. Local authorities are assumed to have a zero default rate due to them being a machinery of government. The default risk attached to other counterparties depends on their creditworthiness and duration of investment. The MCA's treasury advisors provide historic default rates for different types of counterparty as a guide. The risk of default on the £100m of non local authority investments at the end of 2018/19 was estimated to be c. 0.003% or £3k.

It is recommended that this be relaxed a little this to allow for the diversification of the portfolio outside the current narrow range of investment types.
The benchmark for this year is therefore:

- 0.010% historic risk of default when compared to the whole portfolio.

Liquidity
A balance of £25m will be maintained in highly liquid instant access investments / the bank to manage day to day treasury activity.

Yield
The target return on treasury investments is the weighted average return on short term and long term investments.
The latest forecast of returns on short term investments is that there is expected to be a little improvement over the medium term. Our treasury advisors suggest that the target investment earnings rates for returns on short term investments placed for periods up to about three months should be as follows:

2019/20	0.75%
2020/21	0.75%
2021/22	1.00%
2022/23	1.25%
2023/24	1.50%
2024/25	1.75%
Later years	2.25%

The target return on the investment portfolio as a whole (short and long term) is as follows:

Returns on investments	2019/20	2020/21	2021/22	2022/23
	Forecast	Indicative	Indicative	Indicative
	%	%	%	%
Target return on treasury investments	1.22	1.4	1.9	1.9

This assumes that there will be a gradual shift over time towards longer term investments.
If the average return on longer term investments were to increase from 2% to 3%, the target return for the investment portfolio as a whole would increase to 2.1% in 2020/21 rising to 2.3% in 2021/22 and 2022/23

External consultants
Link Asset services have been appointed as treasury advisors to the SCR Group via Treasury Management service level agreement with Sheffield City Council.

Preliminary discussions have been held with the Link on how the investment strategy might be re-shaped and diversified to extract maximum benefit from longer term investment opportunities in the future and provide for greater flexibility. This has entailed looking at other types of investment instrument, reviewing the maximum amounts that can be placed with counterparties, and, how the investment portfolio might be structured and managed to increase yield on longer term investments.

The MCA's bankers have also been approached for options for diversifying and restructuring long term investments.

Where external advisors are appointed to provide specialist skills and resources, officers will ensure that the terms of their appointment and methods by which their value will be assessed are properly agreed and documented.

Commercial investment property
MHCLG statutory guidance to local authorities on investments differentiates between financial investments and investment property portfolios and other non-financial assets held primarily to generate a profit.

The statutory guidance and the Prudential Code require local authorities to give thorough consideration to borrowing for commercial investments where the commercial income generated plays a significant part in sustaining an authority's finances or its exposure to the debt taken out or a downturn in the property market.

This is not applicable to the SCR Group's investment property portfolio which is a legacy of bus deregulation and comprises former transport assets which are not being actively managed to achieve commercial returns. No debt has been taken out to finance these assets. Equally, the income from the investment property portfolio represents only a relatively small proportion 2% of the total budgeted income for the SCR Group in 2020/21.

It is therefore considered low risk at present but will be reviewed should there be any plans to expand the portfolio.