Fund Manager Selection

Investment Sub Committee Friday, 21 January 2022

Report of:	Anna D'Alessandro – Chief Finance Officer (Section 151)
Purpose:	For decision
Publication status:	Unrestricted
Wards affected:	All

Executive summary:

This report updates the Investment Sub Committee on the process to identify an appropriate set of investments to support the Council's medium-term financial objectives and propose an approach to future decision making for financial investments.

Building on the detailed analysis previously undertaken by the Council's treasury advisors, Link Group, and with their further support and guidance, this report proposes a conclusion to the Fund Manager Selection process to recommend the best future portfolio of investments.

This report supports the Council's priority of: Building a better Council/ Supporting economic recovery in Tandridge.

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Recommendations to the Sub-Committee:

That the Sub Committee:

A) Notes the medium-term objective to balance a sustainable level of investment income against the stability of fund value, taking a considered approach to risk management in a changing investment environment.

B) Approves the strategy to provisionally retain current investments (excluding Funding Circle which will continue to wind-down) until a decision has been made by Government on whether to extend the current "statutory override" (para 2.3), which prevents gains and losses in capital value hitting the revenue budget.

C) If the override is not extended, approve disinvestment from these funds at a point where their capital value recovers to at least equal to the amount invested, or if it is clear that their capital value will not recover further:

- Schroders Credit Fund;
- UBS Multi Asset Fund; and
- CCLA Diversified Fund.

Note the intended strategy that, if the override is not extended, the Council intends to re-invest amounts in funds representing the best overall return (through combined capital value and revenue income), in a ratio considered proportionate with the overall fund size. Currently these would be as follows, but fund performance would need to be re-confirmed before any deposit was made. This will be reported back to Investment Sub Committee once a decision is made by Government:

- Royal London Assets Management (RLAM);
- Legal and General Investment Management (LGIM); and
- Newton Multi Asset Income Fund (Newton MAIF)

D) Approves the retention of the CCLA Property fund, offering strong capital and income performance and providing diversity to the overall portfolio.

E) Approves that the balance in the four funds should be retained at a level commensurate with latest projections of long-term cash availability and delegates authority to the S151 officer to amend the balances invested in the funds as necessary to retain a prudent working capital balance.

F) Note that the constitution delegates the execution and administration of treasury management decisions and borrowing strategy to the officer designated for the purposes of Section 151 of the Local Government Act 1972 (i.e. Chief Finance Officer).

Reasons for recommendations:

Having considered a number of alternate options, the recommended approach reflects the current uncertainty in Government policy.

In the longer term, the approach will:

- minimise the potential for losses which may become chargeable against the Council’s revenue budget;
- maximise returns in the context of the potential for changes to the regulatory environment; and
- maintain a revenue income stream in line with the Council’s ability to manage the risk of investment volatility.

1. Introduction and background

1.1. On 24th September 2021, the Investment Sub Committee considered a report from Link Group, the Council’s treasury advisors, on potential options for the reinvestment of £1.3m previously redeemed from Funding Circle. The report also considered whether £12m already invested could be better placed in alternate funds.

1.2. The meeting on the 24th September 2021 concluded with a recommendation that “decisions on possible adjustments to the Council’s investment portfolio be deferred until the Sub-Committee’s next meeting, to be informed by a remodelled report from Link Group identifying the Council’s short, medium and long-term investment position and supporting commentary from the Chief Finance Officer”.

1.3. Subsequent to discussions with Link Group and officers it was agreed to produce this report in order to reconcile investment balances with updated balance sheet position and make further recommendations. This report therefore sets out the results of further consideration undertaken by the Chief Finance Officer, in consultation with Link Group and Surrey County Council’s Treasury Management Centre of Expertise.

1.4. The report recommends that no immediate action be taken at present to amend or add to the Council’s investment portfolio, including reasons why. The report sets out criteria that will, in future, be used to consider changes to the investment portfolio and commits to returning to Investment Sub-Committee should those criteria be met.

2. Key criteria for recommending funds

2.1. The key factors for assessing funds are as follows:

- Income performance – the typical percentage return on the amount invested, paid as an income on an annual basis;
- Capital performance – the likelihood of a fund retaining or growing the capital value invested over time;
- Size and sustainability of the fund – a larger fund would tend to indicate a lower risk profile and less volatility; and
- The Council's risk appetite to the three factors, above.

2.2. The Link Group report presented to the Investment Sub Committee in September did not recommend a set of funds to invest in because, in Link's view, it is a decision for officers and Members of the Council whether to prioritise revenue income, capital growth, or a combination of the two (total return).

2.3. This section sets out a recommended approach. In general, and over the medium-term, funds which offer the highest total return would seem to be the logical choice, however there are two factors which make the decision less straightforward:

- The Council's revenue budget relies on c.£500k per annum of income from the four funds currently holding £12m of investment (set out in Table 1). Given the current budget pressures, there is little room for manoeuvre in pursuing a strategy that would generate less revenue income. This budget requirement would steer the Council towards funds which maintain the current level of revenue budget performance.
- The current regulatory environment[1] means that the Council does not recognise annual gains and losses in the capital value of investments in the revenue budget, unless the investment is withdrawn. This is known as a statutory override, because it overrides usual accounting practice. The current override lasts until 31st March 2023. Government has not yet made a decision on whether to extend, amend or remove the override from that point. Because of this override, the capital performance of funds has been less of an immediate concern in the past.

2.4. The key criteria for recommending a fund are therefore:

- The annual return is maintained without taking risks to the revenue budget from volatile capital values [funds cannot be assessed for this until the future of the override is known]; and
- In the medium-term, the investment portfolio is based around total overall return, from funds that offer a sustainable approach to maintaining investment values.

[1] Regulation 30K of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 as amended by Regulation 5 of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2018 (SI 1207/2018)

2.5. It is therefore recommended that, until the Government has made a decision on the future of the statutory override, the portfolio of investments remains as currently held. This is because the Council cannot determine the medium-term financial impact of changing funds until the future of the override is clear. For example, if the override is not extended, a focus on total return becomes the logical choice. If the override is extended, then income performance in the context of capital stability may be more preferable.

2.6. Recommendations B and C reflect the proposed approach to retain the current funds unless the override is ***not*** extended, in which case switch to a focus on total return.

2.7. Recommendation D proposes retaining the CCLA Property fund investment irrespective, since this offers diversity (representing a different type of investment to the remaining funds) and has performed reasonably well as a total return, as set out in the Link Group report.

3. Current funds

3.1. The Council currently has £12m invested in four funds set out in Table 1, below. Performance of each fund can be judged by the income they generate and by changes in their capital value over time.

3.2. The income provided by each fund in 2020/21 and forecast for 2021/22 is set out for context on income and yield. Two of the funds currently have an investment value lower than the amount invested. The fund value at 31st March 2021 (the balance sheet date) and 31st December 2021 (most recent valuation) are also included in the table.

Table 1 – Capital value and yield of each fund

Investment	Amount invested	Net Asset Value 31/03/21	Value Surplus / (Shortfall) at 31/03/2021	Yield Rate 2020/21	Actual Return 2020/21
	£	£	£	%	£
CCLA Property Fund	4,000,000	4,158,183	158,183	4.33	179,910
Schroders Credit Fund	3,000,000	2,908,911	(91,089)	4.32	125,529
UBS Multi Asset Fund	3,000,000	2,777,398	(222,602)	5.05	140,171
CCLA Diversification Fund	2,000,000	1,955,874	(44,126)	3.17	62,069
Total	**12,000,000**	**11,800,366**	**(199,634)**	**4.30%**	**507,679**

Investment	Amount invested	Net Asset Value Current at end of December	Value Surplus / (Shortfall) at 31/12/2021	Forecast Yield Rate 2021/22	Forecast Return 2021/22
	£	£	£	%	£
CCLA Property Fund	4,000,000	4,672,521	672,521	3.37	157,400
Schroders Credit Fund	3,000,000	2,915,856	(84,144)	4.38	127,600
UBS Multi Asset Fund	3,000,000	2,772,075	(227,925)	4.79	132,800
CCLA Diversification Fund	2,000,000	2,110,463	110,463	2.59	54,600
Total	**12,000,000**	**12,470,915**	**470,915**	**3.79%**	**472,400**

3.3. If the Council were to end its investment in Schroders Credit fund and the UBS Multi Asset fund, the combined (current) reduction in carrying value of £312k would be charged as a loss to the revenue budget. The Council's current budget and reserves position does not support this as an option. This loss would also be charged if the statutory override ended.

3.4. The only means of mitigating the full loss on disposal would be to simultaneously redeem the investment in the CCLA Property fund to take advantage of its increased capital value. It is not recommended to take that option at present for the reasons set out in section 2.7, above.

3.5. It is therefore recommended to remain in these funds until their capital value has recovered to at least equal to the amount invested.

4. How much should be invested

4.1. The current amount invested in the funds under consideration amounts to £12m.

4.2. The Link Group report sets out that at the 31st March 2021, £23m was currently available for investment. This has been reconciled to the Draft Statement of Accounts as follows:

Table 2 – Reconcile Available Balances to Statement of Accounts

	£000
Balance Sheet - Total Reserves	27,653
Add Provisions - the cash backing these is available for investment	2,001
Less Collection Fund Reserve - unavailable for investment as is distributed each year	(6,656)
Subtotal (including rounding adjustment)	**22,999**

4.3. The medium-term cash projections are as follows, comparing the trajectory included in the Link Group report in September, compared to the most recent update. Based on the cash projections in September, particularly for 2021/22, Link recommended that £12m was too high an investment balance for the funds in question. The revised projections show a smoother medium-term balance with a less pronounced dip in 2021/22. This adds weight to the conclusion that the current values can be retained. If cash projections reduce or increase significantly, recommendation E gives delegated authority to the S151 officer to change the balances invested, accordingly.

Table 3 – Updated cash flow projections

	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000
ISC Report 24th September	22,999	16,577	18,311	23,412
Latest	22,999	18,447	18,846	24,264
Movement	**0**	**1,869**	**535**	**853**

4.4. The main reasons for the increase in cash balances are:

- Slippage on the capital programme, particularly Quadrant House (£1.7m) and Disabled Facilities Grants (£0.2m); and
- Revised phasing of capital receipt balances

Note that the request to DLUHC to use capital receipts to meet the c£920k pension budget error has no effect on projected cash balances, since it replaces the use of one reserve (the General Fund) with another (the Capital Receipts Reserve). It does not change the level of cash flow into or out of the Council.

4.5. Currently there is a significant degree of uncertainty in the short, medium and long-term cash position. This uncertainty supports the recommendation to retain the status quo. In the short-term, volatility arises from significant cash receipts in respect of Covid-19 reliefs that are passed on to businesses. In the medium to long-term, available cash will depend on a number of factors including the delivery of the Redstone receipt and any decisions made concerning its use.

5. Other options considered

5.1. Across the eight funds under consideration, only CCLA Property makes the cut in all options considered. The three main options are to pursue:

- Revenue income;
- Capital gain; and
- Total return.

As discussed, without the statutory override, total return would be most appropriate course of action, but this decision cannot be made without further clarity from Government, and at this stage we do not know when this is likely to be.

6. Consultation

6.1. Link Group and the Surrey County Council Treasury Management Centre of expertise were consulted in setting out the recommended approach.

Key implications

7. Comments of the Chief Finance Officer

7.1. A full Balance Sheet review has been undertaken of the Council's borrowing and investments. The continuing approach to the Council's use of internal borrowings as a source of cash for the Capital Programme (rather than being reliant on external borrowing) in the current environment is deemed prudent.

7.2. The Committee should continue to take a holistic view of its investment portfolio to determine if any changes are required as a result of the fund manager selection process as set out in the Link Group report, and future Government decisions on the regulatory environment.

8. Comments of the Head of Legal Services

8.1. The appointed fund manager(s) will need to operate within a framework of prudence and fiduciary duty.

8.2. Arrangements should be in place for the formal measurement of performance of the investments and fund managers. The appointed fund managers should provide a quarterly report on activity, to be summarised by officers and presented to this Committee.

9. Climate change

9.1. There are no significant environmental/sustainability implications associated with the report. It is however recognised that some Council investments may be in companies that are considered to have a detrimental impact on the climate, for example oil companies.

Appendices

Appendix ‘A’ – Link Group – TDC Review of Treasury Management Activity

Background papers

Fund Manager Selection - Investment Sub Committee – 24 September 2021

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