BABERGH and MID SUFFOLK DISTRICT COUNCILS

COMMITTEE: Joint Audit and Standards Committee	**REPORT NUMBER: JAC/23/09**
FROM: Melissa Evans, Director, Corporate Resources	**DATE OF MEETING: 25 September 2023**

ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) UPDATE

1. PURPOSE OF REPORT

1.1 At its meeting on 17th May 2021, the Joint Standards and Audit Committee considered a report on ESG Investments, report JAC/20/19. The recommendations were as follows:

- That the Joint Audit and Standards Committee recommends that the Cabinet pushes its fund managers to filter investments in respect of the ESG considerations, looking for positive contributions to tackling our carbon reduction priorities and that the Cabinet considers withdrawing funds from investors who do not adequately address these concerns.

- The Joint Audit and Standards Committee recognises that any decision to withdraw funds should be balanced against financial prudence.

1.2 Both Cabinets at that time took the decision to monitor treasury investments for each of the ESG aspects and look to make changes to investments at an appropriate time that would strengthen ESG performance but within acceptable financial considerations.

1.3 The purpose of this report is to provide an update on the Councils investment positions and explore some alternative funds in the market with a greater emphasis on ESG.

1.4 Arlingclose, the Council's treasury advisors were commissioned to prepare a report covering three broad options:

- Hold: the ESG credentials of the Council's existing strategic pooled funds
- Switch: the risk and return implications of switching to funds with a greater emphasis on ESG
- Sell: the risk and return implications of selling out of funds entirely to minimise the future borrowing need

1.5 The principles of Security, Liquidity and Yield, as set out in the CIPFA Treasury Management Code and MHCLG Investment Guidance, remain at the heart of local authority treasury decisions and risk management. Incorporation of an ESG policy must not lead to a greater risk of incurring losses from defaults or of receiving unsuitably low investment income.

1.6 The Councils treasury activity should demonstrate compliance with CIPFA's treasury codes; therefore any future borrowing need would require assessment whether the use of proceeds from the divestment of one or more existing pooled funds will help prudently manage treasury risks and optimise net treasury costs.

1.7 Should a decision be taken to divest from one or more of the existing funds, the timing of redemption should be carefully considered to mitigate, to the extent possible, crystalising capital losses. At the current time, the funds' valuations are currently significantly below the initial investment.

2. OPTIONS CONSIDERED

2.1 No options were considered for recommendation.

3. RECOMMENDATIONS

3.1 The contents of this report and the confidential appendix A be noted

REASON FOR DECISION

Not relevant for this report.

4. KEY INFORMATION

Existing funds

4.1 The Councils use Money Market Funds and the Government's Debt Management Office deposit account for short-term investment purposes and to manage daily cash flow requirements.

4.2 As bank securities make up the largest proportion of a Money Market Fund, governance is the dominant of the ESG factors considered when deciding on an issuer's inclusion in a portfolio.

4.3 In recent years however, some Money Market Funds have been launched which apply exclusionary criteria, such as limiting exposure to fossil fuels. Given that most of a Money Market Fund's investments are with financial institutions, whose revenues from the excluded sectors are typically below the thresholds set, these exclusions are unlikely to make a substantial difference to a Money Market Fund's investable universe.

4.4 In addition to its Money Market Funds, each Council has £11m of externally managed strategic pooled equity, property and multi assets funds where short-term security and liquidity are lesser considerations, and the primary objectives instead are regular revenue income and long-term price stability.

4.5 These funds are held with different counterparties and cover a range of asset classes to reduce risk. The funds in which the Councils are invested are detailed below.

Fund	**Asset class**	**Investment Amount**
CCLA: LAMIT Property Fund	Property	£5,000,000
Ninety One (Investec): Diversified Income Fund	Multi Asset	£2,000,000
Schroders: Income Maximiser Fund	UK Equity	£2,000,000
UBS: Multi Asset Income Fund	Multi Asset	£2,000,000

Performance of pooled funds

4.6 The income returns for the Councils existing funds from 31st August 2015 to 31st May 2023 are shown below.

Fund	**Investment**	**Income Return Annualised**
CCLA	£5m	3.74% BDC 3.70% MSDC
Ninety One (Investec)	£2m	3.70%
Schroders	£2m	6.02%
UBS	£2m	3.74% BDC 3.92% MSDC
Total	**£11m**	**4.10% BDC** **4.13% MSDC**

Cost of exiting pooled funds

4.7 The Councils strategic pooled funds are held as long-term investments. Although the total overall return for each of these funds since investment has been positive, they have incurred unrealised capital losses.

4.8 Since 2018/19 the International Financial Reporting Standards for pooled funds states that changes in valuations must be taken through the Comprehensive Income and Expenditure Statement (CIES). The MHCLG has granted a statutory override until 31st March 2025 so these changes will have no impact on the “bottom line”.

4.9 However, upon sale/redemption of these funds any unrealised capital loss has to be recognised in the CIES. This would be a real cost to the Councils and impact on revenue budgets.

4.10 The revenue cost to the Councils of redeeming the existing pooled funds, based on valuations at 31st May 2023 would be as shown below;

Babergh	Purchase Price	Valuation at 31st May 2023	Cost to revenue
CCLA – LAMIT Property Fund	£5,000,000	£4,718,274	£281,728
Ninety One (Investec) Diversified Income Fund	£2,000,000	£1,777,488	£222,512
Schroder Income Maximiser Fund	£2,000,000	£1,529,319	£470,681
UBS Multi Asset Income Fund	£2,000,000	£1,438,631	£561,369
Total	**£11,000,000**	**£9,463,712**	**£1,536,289**

Mid Suffolk	Purchase Price	Valuation at 31st May 2023	Cost to revenue
CCLA – LAMIT Property Fund	£5,000,000	£4,645,294	£354,707
Ninety One (Investec) Diversified Income Fund	£2,000,000	£1,777,488	£222,512
Schroder Income Maximiser Fund	£2,000,000	£1,529,319	£470,681
UBS Multi Asset Income Fund	£2,000,000	£1,436,089	£563,911
Total	**£11,000,000**	**£9,388,190**	**£1,611,811**

5. LINKS TO THE JOINT CORPORATE PLAN

5.1 This report links to the ambition to be carbon neutral by 2030 in the Joint Corporate Plan. The fund managers for the Councils strategic pooled funds are performing well with regards to the integration of ESG factors into their investment decisions and company engagement.

5.2 The income generated by the Councils pooled fund investments contributes to the resources available to the Councils to meet the ambitions of the Joint Corporate Plan.

6. FINANCIAL IMPLICATIONS

6.1 Since inception to 31st May 2023, Babergh and Mid Suffolk's existing funds have provided total income of £3.4m and £3.2m respectively.

6.2 At 31st May 2023, the unrealised capital losses on Babergh and Mid Suffolk's pooled fund portfolios were £1.53m and £1.61m respectively. The statutory override on accounting for gains and losses on pooled investment funds has been extended to 31st March 2025, which ensures that any volatility in fair values does not impact the income and expenditure statement until that date unless funds are sold.

6.3 Selling one or more funds at a redemption value below their purchase price, whether before the expiry of the override, will entail crystallising a capital loss. Timing the sale is therefore important, as the quantum of potential capital loss may represent a significant financial implication.

6.4 The prevailing market outlook suggests that a bearish market characterised by economic uncertainty, persistent inflation concerns, and a hawkish stance from the

Bank of England regarding interest rate hikes. These factors contribute to a highly volatile bond and equity market environment. If the Councils are contemplating selling their funds, it would be prudent to exercise a watching brief for signs of a potential shift in market sentiment towards a more optimistic and bullish market outlook. Strategically timing any redemption from the funds will therefore be of essence.

7. LEGAL IMPLICATIONS

7.1 There are no legal implications arising from this report.

8. RISK MANAGEMENT

8.1 Key risks are set out below:

Risk Description	Likelihood	Impact	Mitigation Measures	Risk Register and Reference*
We may be unable to react in a timely and effective way to financial demands.	3	3	The timing of redemption needs to be carefully managed to mitigate crystalising capital losses	Strategic Risk Register SRR004BDC/MSDC

9. CONSULTATIONS

9.1 None.

10. EQUALITY ANALYSIS

10.1 An equality analysis has not been completed because the report content does not have any impact on the protected characteristics.

11. ENVIRONMENTAL IMPLICATIONS

11.1 All Council activities are being reviewed as part of the work recommended by the Climate Change Task Group and the subsequently agreed Action Plan to support the Councils ambition to be carbon neutral by 2030.

11.2 A key focus of this report is the consideration of the environmental impact of the Councils treasury management investments.

12. APPENDICES

Title	Location
CONFIDENTIAL NOT FOR PUBLICATION Arlingclose ESG Investment Report	Appendix A