

## **Treasury Management Strategy Statement and Annual Investment Strategy 2015/16**

**Cabinet Member:** Councillor Peter Hare-Scott  
**Responsible Officer:** Head of Finance

**Reason for Report:** To agree proposed Treasury Management Strategy and Annual Investment Strategy for 2015/16.

### **RECOMMENDATION(S):**

- 1. That the proposed Treasury Management Strategy and the Annual Investment Strategy for 2015/16, see paragraph 15.4, including the prudential indicators for the next 3 years and the Minimum Revenue Provision Statement (Appendix 4), be approved;**
- 2. That, in addition to a continuation of the current investment strategy, Members give consideration to the options outlined in paragraph 15.5;**
- 3. That Members approve the increase to the 2014/15 Authorised Limit, as detailed in paragraph 7.3.**
- 4. That Members agree to the Council using the Municipal Bond Agency for future loans, see paragraph 13.1.**

**Relationship to the Corporate Plan:** Maximising our return from all associated treasury activities enables the Council to support current levels of spending in accordance with our Corporate Plan.

**Financial Implications:** Good financial management and administration underpins the entire strategy.

**Legal Implications:** Compliance with the Local Government Finance Act 1992 and the Local Government Act 2003 is a legal requirement.

**Risk Assessment:** The S151 Officer is responsible for the administration of the financial affairs of the Council. Implementing this strategy and the CIPFA Code of Practice on Treasury Management manages the risk associated with the Council's treasury management activity.

### **1.0 Introduction**

- 1.1 This report updates Members on our overall Treasury performance during 2014/15 and then recommends a strategy for 2015/16. Clearly this strategy will place investment protection above the level of return.**

## **2.0 Background**

- 2.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
- 2.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing needs of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 2.3 CIPFA defines treasury management as:

*"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

## **3.0 Reporting requirements**

- 3.1 The Council is required to receive and approve, as a minimum, three main reports each year which incorporate a variety of policies, estimates and actuals.

### **Prudential and treasury indicators and treasury strategy (this report)**

- 3.2 The first and most important report covers:
- the capital plans (including prudential indicators);
  - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
  - the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
  - an investment strategy (the parameters on how investments are to be managed).

### **A mid-year treasury management report**

- 3.3 This will update Members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury performance is meeting the strategy or whether any policies require revision.

## **An annual treasury report**

- 3.4 This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

### **Review**

- 3.5 The above reports are required to be adequately challenged before being recommended to the Council. This role is undertaken by the Cabinet.

## **4.0 Treasury Management Strategy for 2015/16**

- 4.1 The strategy for 2015/16 covers two main areas:

### **Capital issues**

- The capital plans and the prudential indicators;
- The minimum revenue provision (MRP) policy.

### **Treasury management issues**

- The current treasury position
- treasury indicators which limit the treasury risk and activities of the Council
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy; and
- policy on use of external service providers

### **Treasury management consultants**

- 4.2 The Council uses Capita Asset Services (formerly Sector) as its external treasury management advisors.
- 4.3 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.
- 4.4 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

## 5.0 Treasury Limits for 2015/16 to 2017/18

### The operational boundary

- 5.1 This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR (Capital Financing Requirement), but may be lower or higher depending on the levels of actual debt.

### The authorised limit for external debt

- 5.2 A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.
- 5.3 This is the statutory duty under Section 3 (1) of the Local Government Act 2003. The government retains an option to control either the total of all Council's plans, or those of a specific council, although this power has not yet been exercised.
- 5.4 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels and housing rent levels is "acceptable".

## 6.0 Current portfolio position

- 6.1 The Council's treasury portfolio position at 15 Jan 2015 included short-term investments/bank deposits to the value of £22.27m. These investments comprised:

	(£m)	
<b>Bank Deposits</b>		
Natwest	4.77	
	<b>4.77</b>	<b>21.42%</b>
<b>Building Society Investments</b>		
Coventry	1.50	
Nationwide	5.00	
	<b>6.50</b>	<b>29.19%</b>
<b>External Bank Investments</b>		
Lloyds	5.00	
Barclays	5.00	
Standard Chartered	1.00	
	<b>11.00</b>	<b>49.39%</b>
<b>Total</b>	<b>22.27</b>	

- 6.2 Members should note that the £22.27m is not made up of fully available cash balances and relates to various aspects of the Council's operation:

	<b>£m</b>
General Fund Balance	2.460
Precept payments (DCC, Fire & Police Authorities)	3.776
General Fund Earmarked Reserve (s106s, New Homes Bonus, vehicle sinking funds, etc.)	5.843
Housing Revenue Account	4.004
Housing Revenue Account Earmarked reserves	4.613
Capital Reserves	1.071
Capital Grants Unapplied	1.357
	23.124

**Notes:**

1. Due to working capital and timing differences, the totals will not agree exactly.
  2. We no longer have an overdraft facility with Natwest as we are asked for a fee of £2k for a £250k facility.
- 6.3 The £4.77m balance held with Natwest is our clearing account where any excess balances are held. At present, a return of 0.50% is gained on this account.
- 6.4 During 2014/15, an average rate of investment return of 0.64% is estimated, generating a sum of circa £92k for the Council. In addition we estimate to receive £18k on current account balances for the year, which will broadly be on budget.
- 6.5 No direct benchmarking against other Authorities is made, however our average return is assessed against the 7 day LIBID rate which is 0.36% at the end of December.
- 6.6 The Council's borrowing position, based on current loans, at year end, will include £42.62m HRA borrowing, £498k General Fund borrowing for a scarab sweeper, leisure equipment and a recycling bailer. All borrowing has been undertaken with the Public Works Loans Board (PWLb) at fixed rates of interest.

## **7.0 Borrowing Requirement**

- 7.1 The Council, for 2015/16, will assess each capital project on a cost/benefit basis and should there be a borrowing requirement these proposals would be brought to Cabinet. Please see Appendix 2 for future years borrowing requirements.
- 7.2 As detailed in the 2012-13 Treasury Strategy, the Council accepted £46.59m in terms of its mortgage debt to purchase its existing housing stock. This debt was paid from a PWLB loan, which the authority has arranged to pay back over a 25 year period at a rate of 2.94% interest.
- 7.3 The Council are undertaking some property acquisitions which may require borrowing within the 14/15 financial year, therefore the authorised limit for this financial year has been adjusted to take account of these decisions. However, they may not be in place until the next financial year, therefore the Authorised Limit needs to be increased to £55.815m for 14/15 (see Appendix 2).

## **8.0 Prudential and Treasury Indicators for 2015/16 to 2017/18**

- 8.1 The prudential indicators, attached as Appendix 2 to this report, are relevant for the purposes of setting an integrated Treasury Management Strategy.
- 8.2 The Council is also required to indicate if it has adopted and continues to comply with the CIPFA Code of Practice on Treasury Management. This was adopted on 7 January 2004 by Full Council and the revised code was adopted at the 11 March 2011 Cabinet.

## **9.0 Prospects for Interest Rates**

- 9.1 The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.
- 9.2 Capita Asset Services Bank Rate forecast remains unchanged at 0.50% until the beginning of Q4 2015 (see Appendix 3 for detailed forecasts).

## **10.0 Borrowing Strategy**

- 10.1 The 2015/16 budget has been compiled on the basis that there may be some significant capital investment in 2015/16, principally concerning land acquisition and additional spend to save projects.
- 10.2 The HRA mortgage debt of £46.59m was confirmed in early 2012. The Council took advice on counterparty options and optimal debt structuring. Central Government instructed the PWLB to offer a discounted borrowing rate (0.85% below its standard lending rate) which was clearly the best option for the Authority. The Authority has undertaken a 25 year annuity. Interest rates will

be monitored and will have consideration to the 30 year property maintenance requirements included in the HRA business plan.

## **11.0 Policy on borrowing in advance of need**

11.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

## **12.0 Debt rescheduling**

12.1 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

12.2 The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

12.3 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

12.4 All rescheduling will be reported to the Cabinet at the earliest meeting following its action.

## **13.0 Municipal Bond Agency**

13.1 It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority intends to make use of this new source of borrowing as and when appropriate.

## **14.0 Annual Investment Strategy**

### **Investment Policy - changes to credit rating methodology**

- 14.1 The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts". This process may commence during 2014/15 and / or 2015/16. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology are required.
- 14.2 It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.
- 14.3 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.
- 14.4 Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.
- 14.5 As with previous practice, ratings will not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and will take account of this information on top of the credit ratings.
- 14.6 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- 14.7 The borrowing of monies purely to invest or on-lend to make a return is unlawful and this Council will not engage in such activity.



- 14.8 At present the Council does not invest sums for periods longer than one year with the majority of deposits being made at fixed rates of interest, with the option to enter into variable interest rate deposits. This will include Certificates of Deposit (not exceeding 20% of our investment portfolio).
- 14.9 See Appendix 1 for the listing of current applicable counterparties.

## 15.0 Lending Criteria and Counterparty Limits

- 15.1 The Council's lending policy has evolved from investing with the Debt Management Office exclusively in 2009, to using most major UK Banks and Building Societies, subject to strict credit criteria for an investment duration no longer than one year, in 2012.
- 15.2 **Banks:** UK based and assessed on high level applicable short term Fitch ratings (F1,F1+) with consideration to negative reviews from Moody's and Standard & Poor's. A maximum of £5m funds held with any group, this includes the use of Certificates of Deposit which are more liquid than fixed term deposits.
- 15.3 **Building Societies:** UK based and assessed on Fitch short credit ratings of F1 and the organisation to have an asset base minimum of £1bn. The £5m counterparty limit also applies.
- 15.4 **Investment options:** This report recommends that the Council continues with the investment policy currently in place for 15/16.
- 15.5 Other areas which will be explored are the following:
- Property Investment Fund tailored to Local Authorities, such as CCLA.
  - Investment grade Corporate Bonds

These areas will be investigated further and a future report will be made detailing the merits/drawbacks of these investment options.

- 15.6 Given the timing of the report and the uncertainty around interest rates due to economic and political factors (General Election) there is no strong case to radically change the policy, however, going forward, a consideration of the options at 15.5, would potentially augment the returns we get on our current policy.
- 15.7 In addition to these fixed term deposits, the Council also uses an instant access liquidity account with the National Westminster Bank (the Council's own banker) to sweep any small surplus funds which cannot be placed by our brokers. Again, this account is subject to the same £5m maximum deposit level.
- 15.8 The Council will also continue to lend to:
- Local Authorities, Police and Fire & Rescue Authorities
  - DMOADF

- 15.9 None of the investments made to organisations stated in paragraph 15.8 will be constrained to a maximum deposit of £5m or term deposit limit due to the low level of attached risk.
- 15.9 In addition to these standard arrangements it should be noted that the Council will see a greatly reduced lending portfolio based on circa £5m being lent between the GF and HRA. This will significantly reduce the counterparty failure risk which the GF is exposed to and increase the rate of return to the GF and reduce the interest rate cost to the HRA.
- 15.10 It should be noted that the Cabinet will receive a half yearly review of treasury performance which will include an update on where any surplus monies are invested and the rate of return generated on them. This could also include an amendment to the overall strategy if additional information or a change in the level of risk attached to any of the counterparties is forthcoming.

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**Background Papers:** Capita Briefing Papers – 07 January 2015

**Circulation of the Report:** Cllr Peter Hare-Scott, Management Team